APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
for the Fifth Circuit

No. 83-4390

TEXAS EASTERN TRANSMISSION
CORPORATION, ET AL.,
Petitioners,

vs.

FEDERAL ENERGY REGULATORY
COMMISSION,
Respondent.

On Petition to Review Orders of
The Federal Energy Regulatory Commission

No. 83-4162

ASSOCIATED GAS DISTRIBUTORS,
Petitioner,

v.

FEDERAL ENERGY REGULATORY
COMMISSION,
Respondent.

On Petition for Review of an Interim Rule of the
Federal Energy Regulatory Commission

No. 85-4182

TRANSCONTINENTAL GAS PIPELINE CORPORATION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION
Respondent.

On Petition for Review of an Order of the Federal Energy Regulatory Commission

(August 19, 1985)

Before GARZA, JOHNSON and DAVIS, Circuit Judges.

GARZA, Circuit Judge:

I.

These consolidated appeals[1] involve the Federal Energy Regulatory Commission's ("Commission") handling of three rather distinct issues under the Natural Gas Policy Act of 1978, 15 U.S.C. Section 3301 *et seq.* ("NGPA").

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1. Case 83-4162 was brought to challenge the Section 110 allowances at the Interim Rule stage. Those challenges were premised on various alleged procedural irregularities. Case 83-4390 concerns those same allowances at the final stage, as well as the Title I declaratory order and the certificate conditions issues.

We are urged by some parties to reach the administrative problems raised in Case 83-4162 as "capable of repetition and evading review." We believe that in view of Case 83-4390, those contentions are simply moot and decline the invitation to review them.

Case 85-4182 was consolidated with these cases after oral argument, as it raises the same issues as Case 83-4390.

First, the Commission issued a number of regulations outlining when a first seller of natural gas can recover certain production-related costs under Section 110(a)(2) over and above the Congressionally established maximum lawful price. The Commission's regulations on this subject are challenged for varying reasons by several groups of parties. The Indicated Producers[2] ("Producers") generally support the Commission's approach to the Section 110 issues, but they disagree with regard to a few specifics.

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2. The Indicated Producers consist of the following individuals, corporations, and other legal entities.

Amerada Hess Corporation
Aminoil Inc.
Amoco Production Co.
Arco Oil and Gas Company
Ashland Exploration, Inc.
Cabot Petroleum Corporation
Chevron U.S.A., Inc.
Cities Service Oil and Gas Corporation
Conoco Inc.
Diamond Shamrock Corporation
Elf Aquitaine, Inc.
Exxon Corporation
Getty Oil Company
Gulf Oil Corporation
J.M. Huber Corporation
Hunt Oil Company
Estate of H. L. Hunt
Hassie Hunt, Inc.
Hunt Industries
Hunt Petroleum Corporation
A. G. Hill
Caroline Hunt Schoellkopf
Lamar Hunt
N. B. Hunt
W. H. Hunt
Caroline Hunt Trust Estate
Lamar Hunt Trust Estate
W. H. Hunt Trust Estate
Secure Trusts
Inexco Oil Company
Kerr-Mcgee Corporation
Marathon Oil Company
Mitchell Energy Corporation
Mobil Oil Corporation
Mobil Producing Texas & New Mexico Inc.
Mobil Oil Exploration & Producing Southeast Inc.
Monsanto Oil Company
Pennzoil Company
Pennzoil Producing Company
Pennzoil Oil & Gas, Inc.
Pennzoil Louisiana and Texas Offshore, Inc.
Phillips Petroleum Company
Phillips Oil Company
Placid Oil Company
Sohio Petroleum Company
Sun Exploration and Production Company
Tenneco Oil Company
Texaco Inc.
Texas Production Company
Ecee, Inc.
Pinto, Inc.
The Superior Oil Company
Union Oil Company of California
Williams Exploration Company

The Pipeline Petitioners and Intervenors[3] ("Pipelines"), The Associated Gas Distributors[4] and the Public Service

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3. The Pipeline Petitioners and Intervenors consist of the following companies:

Interstate Natural Gas Association of America
ANR Pipeline Company
Colorado Interstate Gas Company
Natural Gas Pipeline Company of America
Transcontinental Gas Pipe Line Corporation
Panhandle Eastern Pipeline Company/Trunkline Gas Company
Sea Robin Pipeline Company
Southern Natural Gas Company
Tennessee Gas Pipeline Company
Texas Eastern Transmission Corporation/Transwestern Pipeline Company
United Gas Pipeline Company

4. The Associated Gas Distributors is composed of the following companies:

Baltimore Gas & Electric Company
Bay State Gas Company
The Berkshire Gas Company
Boston Gas Company
The Brooklyn Union Gas Company
Central Hudson Gas & Electric Corporation
Chesapeake Utilities Corporation
City of Holyoke, Mass., Gas & Electric Department
City of Westfield Gas & Electric Light Department.
Colonial Gas Company
Commonwealth Gas Co.
Concord Natural Gas Corp.
Consolidated Edison Company of New York, Inc.
Delmarva Power & Light Company
Elizabethtown Gas Company
Energy North, Inc.
Essex County Gas Company
Fitchburg Gas & Electric Light Company
Lynchburg Gas Company
New Jersey Natural Gas Company
New York State Electric & Gas Corporation
North Carolina Natural Gas Corporation
Northeast Georgia Municipal Gas Utilities
Northeast Utilities
Northern Utilities, Inc.
Pennsylvania Gas & Water Company
Pequot Gas Co.
Philadelphia Electric Company
Philadelphia Gas Works
Providence Gas Company
Public Service Company of North Carolina, Inc.
Public Service Electric &
Public Service Electric & Gas Co.
South County Gas Co.
The Southern Connecticut Gas Co.
UGI Corporation
Valley Gas Co.
Washington Gas Light Co.

Commission of New York[5] take broader exception to the Commission's approach. With only minor modifications, we affirm the Commission's disposition of this question as a reasonable accommodation of the varying policies at issue.

The second major issue presented involves the Commission's Title I Declaratory Order. In that order, the Commission approved a contracting practice whereby a seller-producer receives from a pipeline-purchaser the free or below-cost transportation of the seller-producer's own hydrocarbons (liquids and liquefiables) in addition to the maximum lawful price. The Producers generally support the Commission on this issue. The Pipelines, as well as the Associated Gas Producers, challenge the Order as an unacceptable loophole in the price structure Congress intended in Title I of the NGPA. As explained below, we affirm the Commission on this issue.

The third issue raised involves a number of conditions which the Commission placed on various pipelines' certificates of public convenience and necessity pursuant to its jurisdiction under the Natural Gas Act ("Gas Act"), 15 U.S.C. § 717, *et seq*. These conditions generally prohibit a pipeline-purchaser from recovering in its rate proceedings those costs that it incurs in transporting producer-owned liquids and liquefiables. Certain Pipeline Petitioners[6] challenge these conditions. The Commission

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5. This New York entity joins the Associated Gas Distributors on their brief on most issues. Reference to the Associated Gas Producers therefore normally suffices to identify a position as that of the New York Public Service Commission as well.

6. Certain Pipeline Petitioners consist of the following:

Texas Eastern Transmission Corporation/Transwestern Pipeline Company
Sea Robin Pipeline Company
Panhandle Eastern Pipeline Company/Trunkline Gas Company
Southern Natural Gas Company
United Gas Pipe Line Company

and two pipelines[7] note that the case has been settled for a period of years and is therefore not ripe. We agree and decline to review that decision.

Each of these issues is developed more fully below.

II.

The first set of issues presented in this case arises under Section 110(a)(2) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3320(a)(2) (1982). Section 110(a)(2) allows a first seller of natural gas to charge an amount exceeding the applicable maximum lawful price "to the extent necessary to recover . . . any costs of compressing, gathering, processing, treating, liquefying, or transporting such natural gas, or other similar costs, borne by the seller and allowed for, by rule or order, by the Commission." In an attempt to carry out the requirements of Section 110(a)(2), the Commission issued a series of orders.[8]

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7. ANR Pipeline Company and Transcontinental Gas Pipe Line Corporation join the Commission in arguing the case is not yet ripe. However, they concur with the other pipelines on the merits.

8. Order 94, the Interim Rule, was issued July 25, 1980. In it, the Commission announced its intention to do a study to determine the appropriate level for delivery and compression allowances for Interstate gas. It further announced that any amounts later determined appropriate would be made retroactive to the Order's date.

Orders 94-A and 94-B amended these orders to provide the promised allowances. Order 94-B, promulgated January 24, 1983, also provided, for the first time, for some allowances for sellers of Section 105 and 106(b) gas (intrastate gas).

Orders 94-C and 94-D denied rehearing of these orders on May 24, 1983.

Order 334, promulgated September 27, 1983, made the Interim Rule final, leaving it intact in most respects.

The orders' provisions are described in greater detail where relevant in the text.

In essence, these orders created a scheme of generic allowances that permit sellers of gas (other than Section 105 and 106(b) gas)[9] to recover much of these production-related costs at a predetermined level[10] and, in most cases, without the Commission's involvement. The different parties (other than the Commission) take issue with these orders in varying degrees. The Associated Gas Distributors and the Pipelines fundamentally disagree with the notion of an across-the-board generic allowance for these production-related costs. Moreover, even assuming the viability of the generic approach, the Pipelines point to a number of specific effects and requirements of the generic allowances promulgated as being especially arbitrary. The Producers on the other hand, strongly concur in the generic approach generally, but point to a few areas where the proposed allowances are inadequate, either because of time frame or subject matter. Finally, the Commission maintains that the orders are rational in all respects.

A.

We find no merit in the Associated Gas Distributors and the Pipelines' contention in their briefs that a generic approach to allowances is not contemplated under Section 110(a)(2).[11] This argument against generic allowances

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9. Section 105 and 106(b) gas were treated somewhat differently. The issues relating to these categories of gas are discussed in part II D., *supra*.

10. These allowances are fully explained in 18 C.F.R. § 271.1104. The specific amounts involved are discussed, where relevant in the text of this opinion.

11. Indeed, at oral argument the Pipelines themselves recoiled somewhat from this position, acknowledging that generic allowances might be permissible under certain narrow circumstances.

necessarily depends on their assertion that allowances of whatever type under Section 110 were intended to be rather exceptional. This is so, because a case-by-case assessment of the propriety of Section 110 allowances in the many contracts for Section 104 and 106(a) gas would be plainly infeasible as an administrative matter.[12]

By its terms, Section 110 authorized allowances "to the extent necessary" to enable the seller to recover production-related costs; whether the allowances were intended to be widely applicable turns largely on the appropriate reading of "necessary." The Associated Gas Distributors and the Pipelines maintain that "necessary" means something more than "incurred;" for if Congress meant to authorize reimbursement to a seller of all production-related costs, they argue, it would have chosen far simpler language. The Congress therefore, according to the Pipe lines and the Associated Gas Distributors, must have intended an elaborate regulatory scheme to enable the Commission to distinguish the usual case, where the maximum lawful price adequately compensates a first seller, from the extraordinary case, where an additional allowance is required to defray the seller's production-related costs. The Commission responds that its order gives "necessary" a more reasonable reading. The Commission notes that it based the allowances on industry cost averages, thereby assuring that they would accurately reflect the costs "necessarily" associated with these production-related activities. As an added assurance that only necessary costs would be recovered, the Commission notes that its order limited the amount recoverable to the amount provided

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12. Indeed, the Commission's earlier experience prior to Order 94, which provided for a case-by-case approach, clearly confirms the impracticability of that approach. R. at 1666-78, 1840-46, 6074-75.

by the generic allowance or the amount provided by contract, whichever is less. Thus, according to the Commission, the course of bargaining between a producer and a pipeline will assure that unnecessary costs will not be recovered in any given case.

We find the Commission's position on this issue the more persuasive. The Pipelines and the Associated Gas Distributors have failed to demonstrate that the Commission's approach is unfaithful to the purpose of Section 110. Significantly, the very language of the statute provides for reimbursement of these production-related costs by "rule or order." The drafters' choice of the words "rule or order" in this context clearly contemplates the establishment of an industry-wide scheme of reimbursement. The generic scheme which was developed is further consistent with Section 110's requirement of necessity. "Necessity" in this context requires only that an allowance be a reasonable approximation of costs actually incurred by a seller in a production-related activity. These generic allowances clearly comport with that statutory requirement.

The Associated Gas Distributors and the Pipelines next argue that, even assuming generic allowances are permissible under Section 110, the Commission erred in acting as though they are mandated by that provision. In particular, they argue that the Commission should have carefully considered the impact that these allowances would have on the natural gas market, especially given the tumultuous circumstances facing the gas market at that time. The Commission responds that it took care to minimize the impact of the allowances on the market, both by allowing for the establishment of a lower rate by contract and by basing the allowances themselves on

a comprehensive cost study. Other than these attempts to minimize the market impact of the allowances, the Commission felt bound by the statutory mandate that it grant allowances where "necessary."

The Commission did not behave irrationally in deferring to Congress's market evaluation as reflected in Section 110 itself. The Commission's duty in this situation is to effectuate Section 110's directives in a reasonable way. We are, moreover, not persuaded that the Commission acted irresponsibly in the face of the gas market conditions. Accordingly, we find no merit to the Pipelines' attack on the generic allowance scheme as a whole.

B.

The Pipelines and the Associated Gas Distributors next take issue with a number of specific applications of the generic delivery allowances. Our inquiry with respect to each of the situations is limited to evaluating "the effort the Commission has made and whether the Commission has 'given reasoned consideration to each of the pertinent factors.' " *Tenneco Inc. v. F.E.R.C.*, 571 F.2d 834, 839 (5th Cir. 1978), *cert. dismissed*, 439 U.S. 801 (1978) (quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968)).

The Pipeline Petitioners and the Associated Gas Distributors note that the Commission's regulation with respect to new (post-NGPA) delivery systems provides for an allowance of seven cents per MMBtu for the first mile or less and two cents per MMBtu for each mile thereafter.[13] 18 C.F.R. § 271.1104(d)(1)(i)(B). The

13. This allowance is recoverable to a maximum of twenty miles.

delivery allowance for a pre-NGPA system is five cents per MMBtu, regardless of the system's length. *Id.* at § 271.1104(d)(1)(i)(A). In the case of a combined new and old system, the regulation provides for the collection of both allowances, a result which the Pipelines and the Associated Gas Distributors find especially arbitrary.

We find no merit whatever to these attacks on either the old or new system allowance standing alone. The Commission's choice of cut-off lengths is amply supported by the record. The fact that a new delivery system of even very short length could receive the full seven cents per MMBtu is simply a function of this administrative necessity. Moreover, the Pipelines and the Associated Gas Distributors have failed to demonstrate any real prejudice that results from this approach.[14]

The result reached with respect to a combined system (composed of both new and old systems) is, in certain situations, more problematic. A combined system composed of a very short old system and a new system might receive a greater allowance than an entirely new system.[15]

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14. It is also noteworthy that the Commission has in place a Production Related Costs Board. 18 C.F.R. § 271.1105. This Board can assure that no allowance will be collected as the result of a new delivery system of very short length, built for the sole purpose of collecting an allowance.

15. As an example, the Pipeline Petitioners proffer a system composed of one mile of new system and two miles (or any lesser length) of old system. If the system were entirely new and three miles in length, the applicable allowance would be eleven cents ($.07 + $.02 + $.02) per MMBtu. Under the current Commission regulations the allowance for a combined system of two miles old and one mile new is twelve cents ($.05 + $.07) per MMBtu. If the hypothetical system were composed of a few feet of old and three miles of new, the allowance would be sixteen cents ($.07 + $.05 + $.02 + $.02) per MMBtu.

The Commission argues that this result is merely an aberration in an otherwise fair scheme, and that we should limit our consideration to the fairness of the scheme as a whole. The Commission further argues that the record shows that the hypothetical case posed by the Pipelines and the Associated Gas Distributors will be very unusual in the real world. R. at B1560-61. Accordingly, the Commission concluded that the cost of ascertaining the length of old systems, unnecessary under the present system, would greatly outweigh the slight benefits of a more exact means of calculating the appropriate allowance for a combined system. We find support for this conclusion in the record and sustain it.[16] R. at B1561.

The Pipelines and the Associated Gas Distributors challenge the application of the generic delivery allowance in yet another context: offshore drilling rigs. They note that, typically, delivery systems offshore are quite short, often only a few feet, but that the producer nonetheless receives the same minimum allowance received on shore. 18 C.F.R. § 271.1104(d)(ii). Accordingly, they argue that the Commission erred first, in providing for any allowance in the offshore situation and, second, in failing to consider the offshore sites separately from those onshore. The record, however, demonstrates that allow-

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16. The Pipelines and the Associated Gas Distributors maintain that the argument relating the administrative inconvenience of measuring old systems is specious, in that measurement is already required for new systems. The difference of course, lies in what is gained by the measurement. In the case of new systems, it is absolutely necessary to an implementation of the fair system the Commission has conceived. In the case of old systems, measurement would provide no more than an occasional and small variation in an allowance for a combined system. The benefit, therefore, of measurement with respect to the old systems is far smaller.

ances have long been provided for in the case of offshore delivery. *See* R. at B1554. Nothing in the history or language of the NGPA compels a different result. As for their amount, the Commission recognizes that the delivery systems offshore are frequently quite short. Nonetheless, the Commission found that this was offset by the fact that the producer bears the cost of the platform, thereby greatly increasing the effective cost of the system.[17] Accordingly, the Commission's disposition of this issue is supported by the evidence and will be sustained.

The Pipelines and the Associated Gas Distributors also challenge two commingling requirements imposed by the Commission's regulations. First, the Commission required that in order for a seller to collect a delivery allowance on gas hauled through a new system, the "gas hauled must be commingled with other gas at or before the point of the final first sale;"[18] nonetheless, the Commission refused to require commingling with respect to new delivery systems. Second, the Commission required that commingling of gas from other wells occur downstream from a separator of oil well gas; the Commission imposed no such requirement with respect to gas from gas wells.[19] We find the Commission's reasons for these requirements to be persuasive. With respect to the first commingling requirement, it is imposed to assure that redundant new delivery lines are not constructed merely in order to collect an additional allowance. This requirement makes no sense with regard to old systems, where the allowance is collected regardless of the length of the system. With

17. At oral argument, the Pipelines characterized this rationale as "post-hoc." The record belies that assertion. R. at B1556.

18. 18 C.F.R. § 271.1104(d)(1)(ii).

19. R. at 1341-1412.

respect to the second commingling requirement, there is simply no need for a "downstream" requirement with respect to separators for gas well gas, whereas the area "upstream" from a separator for oil well gas is primarily an oil system. R. at B1368-69. These requirements are manifestly reasonable exercises of the Commission's discretion.

The Associated Gas Distributors argue, finally, that the Commission erred in Order 94-A in eliminating minimum gas quality standards under the new regulatory scheme. The minimum quality standard under Order 94, the previous regulation, set a benchmark quality level for marketable gas. Under that plan, processing costs incurred in bringing the gas up to minimum quality standards were not recoverable under Section 110. The Associated Gas Distributors argue that the prior plan reflected congressional intent that the maximum lawful price adequately compensates for gas at the minimum quality level; that is, that no Section 110 allowance is appropriate when incurred in raising the quality up to merely minimum quality.

The Commission counters, persuasively in our view, that nothing in the history of the NGPA limits Section 110 allowances to gas of a certain minimum quality. The Commission concedes that the result of the Order 94-A approach is to allow a seller of gas produced at a sub-minimum quality standard but further processed up to minimum quality to receive a greater effective price[20] than a seller who produces gas already at the minimum quality level. The Commission takes exception with the

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20. The producer of this type of gas receives a greater effective price in that it is allowed to collect a Section 110 processing allowance in addition to the maximum lawful price.

Associated Gas Distributors' characterization of this result as "anomalous"; however, this result leads to an important incentive for the production of the lower-quality gas. This strikes us as entirely reasonable. Moreover, the maximum lawful price is merely a ceiling. The parties are therefore free to handle this contractually. We find no abuse of the Commission's discretion.

C.

The Producers, while in general agreement with the Commission's approach, challenge four specific aspects of the regulations relating to interstate gas[21] under Section 110. First, the Producers maintain that the Commission erred in holding that an area rate clause[22] does not authorize collection of the compression allowance. *See* 271.1104(c)(4)(ii)(B). Second, the Producers challenge the Commission's denial of a compression allowance with respect to pre-NGPA systems. *See* 18 C.F.R. § 271.1104(d)(1)(iv); R. at 6212. Third, the Producers challenge the refusal of the Commission to make all production-related allowances retroactive to 1978, the year of the passage of the NGPA. Fourth, the Producers challenge the Commission's denial of interest for the periods in which retroactive allowances were recoverable.

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21. The Producers' challenges to the Commission's handling of intrastate gas is discussed in Section IID, *infra*.

22. 18 C.F.R. Section 154.93(b)(1)(ii)(B) validates gas contract provisions that permit "a change in price to the applicable just and reasonable area ceiling rate which has been, or which may be, prescribed by the Commission for the quality of gas involved." Provisions pursuant to that regulation are called "area rate clauses." The actual language of the clauses varies from contract to contract. Nonetheless, this court has held that such provisions may generally be read to permit a producer to charge the NGPA's maximum lawful price. *Pennzoil Co. v. F.E.R.C.*, 645 F.2d 360, 389 (5th Cir. 1981), *cert denied*, 454 U.S. 1142 (1982).

With respect to the first, third and fourth issues above, the Pipelines also challenge the Commission's orders but for different reasons. With respect to the first issue, the Pipelines maintain that the Commission erred in holding that an area rate clause authorizes even a delivery allowance. As for the third and fourth issues, the Pipelines maintain that the Commission should not have permitted any retroactive recovery of either allowances or interest. These issues are discussed in turn.

The first question relates to the Commission's decision that an area rate clause would authorize the collection of a delivery allowance, where otherwise appropriate,[23] but would not authorize the collection of a compression allowance or any other production-related costs recoverable pursuant to Section 110. The Pipelines and the Associate Gas Distributors note that the regulations generally require express contractual authorization for the collection of any allowance. *See* 18 C.F.R. 271.1104 (a)(3). Nonetheless, the Commission finds express authorization in the very general language of an area rate clause. *See id.* at § 271.1104(c)(4)(ii)(B). This second provision clearly does violence to the express authorization requirement, according to the Pipelines and the Associated Gas Distributors. In any event, area rate clauses vary widely in language and intent; the Pipelines and the Associated Gas Distributors read the 1981 *Pennzoil* decision to require that these clauses be evaluated on a case-by-case basis. The Producers, on the other hand, find arbitrariness only in the limitation on the area rate clause; they argue that an area rate clause should

23. 18 C.F.R. § 271.1104(c)(4)(ii)(B), by its terms, applies only to certain categories of interstate gas. The propriety of the distinction between interstate and intrastate gas is discussed below in Part IID.

authorize the collection of any production-related allowance permitted by the Commission pursuant to Section 110.

The Commission argues that prior experience under the Gas Act, 15 U.S.C. 717 *et seq.*, supports the construction of area rate clauses as authorizing delivery allowances. On the other hand, the Commission urges that compression allowances were not allowed under the Gas Act and therefore could not have been foreseen by the parties to an agreement containing an area rate clause. As a general matter, these bases strike us as unassailable. It is troublesome, however, that the Commission did not clearly provide for a protest procedure to allow parties the opportunity to show that the intent of the parties with respect to certain area rate clauses is inconsistent with the general rules set out above. For the first time in this appeal, the Commission apparently does not dispute the propriety of a challenge under the general protest provisions under Section 101(b)(9) of the NGPA, 15 U.S.C. § 3311(b)(9). However, because of the paramount importance of intent under individual contracts,[24] the Commission should amend its order 94-A to make clear that in a particular case, an aggrieved party is entitled to attempt to show that its area rate clause is not subject to the presumptions of Order 94-A. The procedures utilized in the former Order 23-B should serve as a model for the required procedures. With this modification, the Commission's treatment of this issue is affirmed.

The second issue raised by the Producers relates to the Commission's denial of any compression allowance vis-a-vis pre-NGPA systems. *See* 18 C.F.R. § 271.1104 (d)(1)(iv). With respect to post-NGPA systems an al-

24. *See Pennzoil v. FERC, supra,* 645 F.2d at 388-90.

lowance is created to reimburse a first seller for qualified stages of compression, as well as for the cost of fuel to drive the compressor. The Commission urges a rational basis in the exclusion of old systems in that sellers were adequately compensated for these costs under Gas Act area and nationwide rates. R. at B702-03. More importantly, no specific allowance for compression was provided for under prior law; therefore, sellers with pre-NGPA systems had no expectation of specific compensation for compression. The record clearly supports this basis. R. at 842-48. Accordingly, we sustain the aspect of the Commission's decision relating to the recovery of capital costs. On the other hand, the Commission has come forward with no sound basis for the exclusion of fuel costs, which are current expenditures, with respect to pre-NGPA systems. Therefore, we instruct the Commission to modify its order to allow for the recovery of fuel and power costs with respect to pre-NGPA systems. These costs are recoverable to the same extent and retroactive to the same date from which they have been recoverable up to now with respect to post-NGPA facilities.

In their third challenge, the Producers, including Phillips Petroleum,[25] quarrel with the Commission's failure to make all production-related allowances recoverable retroactive to 1978, the year of the NGPA's passage. The Pipelines and the Associated Gas Distributors, on the other hand, maintain that the allowances should be collectable only from 1983, the time provided for when the allowance was finally established in Order 94-B. Prior to that time, the Pipelines argue, no Commission

25. Phillips further urges that the delays are so unwarranted as to justify special relief, as well as a declaration with respect to future Commission delays of this magnitude. Because of our disposition of this issue, we decline Phillips' request for special relief.

uthorization existed for collection of an allowance; and Commission authorization is an explicit requirement of Section 110. To this argument of the Pipelines, the Commission responds that it had promised in Order 94 that allowances eventually created with respect to interstate gas would be retroactive to that date. Contrary to the Pipeline's characterization of this promise as "ultra vires," we believe it was a fair balancing of the various problems involved: the sellers' need for allowances, the purchasers' need for notice, and the Commission's need to make a thorough study prior to setting allowances. Similarly, we are unpersuaded by the Producers' contention that the Commission delayed unnecessarily in establishing allowances.[26] The Commission's disposition of this point is upheld. In any event, rules of this type should be made retrospective, absent adequate notice only in rare cases. *See Transwestern Pipeline Co. v FERC* 626 F.2d 1266, 1271 (5th Cir. 1980), *cert denied,* 451 U.S. 937 (1981). We are not convinced that this is such a case.

Finally, the Producers challenge the Commission's failure to assess interest[27] against the purchasers on retroactive allowances awarded. R. at 6142. The Producers argue with some force that this situation is highly analogous to a rate refund, where interest would be recoverable. *See* 18 C.F.R. § 154.102(c)(2). Nonetheless, the Commission is clearly empowered to stray from its general regulation in the interest of equity. *Shell Oil Co. v. F.E.R.C.,* 664 F.2d 79, 83 (5th Cir. 1981). As part of this overall scheme of retroactive allowances, the ex-

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26. Accordingly, we do not reach the issue of whether retroactive allowances to 1978 would be the appropriate subject of judicial fiat even if undue delay by the Commission were shown.

27. Interest is recoverable with specific contractual authority.

clusion of interest results from a reasonable balancing of the equities. This is so, because while the purchasers were on notice as of 1980 that allowances would eventualy be promugated, they were not on notice as to the amount. Moreover, if the Producers had wanted to assure the collection of interest retroactively, they could have done so contractually.[28] Under the specific circumstances of this case and in view of the Commission's attempt to reach a fair result with respect to the Section 110 issue as a whole, we believe that the Commission acted within its discretion.

D.

The final issues arising from the Section 110 allowances relate to the Commission's making distinctions between interstate gas and Section 105 and 106(b) gas (intrastate gas and intrastate rollover gas, respectively; hereinafter collectively called "intrastate gas") in its regulations regarding allowances. The Producers brand two aspects of these distinctions as "discrimination against intrastate sellers." First, the Producers urge against the Commission's decision making intrastate allowances collectable retroactive only to 1983 rather than 1980, the year allowed vis-a-vis interstate gas. Second, the Producers challenge the Commission's finding that area rate clauses in intrastate gas contracts do not authorize the collection of a delivery allowance as they do with regard to interstate gas. This final contention is based, first, on the

28. The Producers maintain that they did not seek contractual relief because they thought it unnecessary in view of the Commission's general policy favoring interest. Nonetheless, the Producers concede that they were aware of the Commission's *Shell Oil* power to disallow interest in a specific case. Therefore, the short answer to the Producers' argument is that their ill-founded reliance on Section 154.102(c)(2) does not bind the Commission or this Court.

notion that the Commission lacked jurisdiction to "interpret" the intrastate contracts and, second, that even assuming Commission jurisdiction, the Commission's "interpretation" of the area rate clauses is erroneous. These contentions are considered below.

The Producers' first allegation of "discrimination" against intrastate sellers stems from the Commission's decision to make intrastate allowances recoverable only from 1983, the effective date of Order 94-B. In the case of interstate gas, delivery and compression allowances were made collectible retroactive to 1980, the date of Order 94. The Commission defends this distinction by noting that in Order 94, the Commission promised that the generic delivery and compression allowances that it eventually promulgated would be retroactive to that order's date. No mention was made of allowances for intrastate sellers, because at that time such sellers were expressly prohibited from receiving allowances under Order 68-A. R. at A94-98, A116. We believe that the Commission's distinction is therefore rational. Indeed, if the intrastate allowances had been made retroactive to 1980 in spite of the fact that they were first mentioned in 1983 in Order 94-B, we would now be evaluating a case of clear retroactive rate-making. The Commission did not err in freeing us from that evaluation.

The Producers next argue that the Commission erred in determining that area rate clauses in intrastate gas contracts do not authorize the collection of a generic delivery allowance. They base this assertion on two points: first, that the Commission lacks jurisdiction to "interpret" intrastate contracts and, second, that, even assuming jurisdiction, the Commission erred in its "interpretation" of the area rate clauses. The Commission argues that it

is not interpreting these clauses but rather establishing reasonable eligibility requirements. R. at 6478.

The power of the Commission to establish eligibility standards for the collection of special rates was upheld by this Court in *Pennzoil Co. v. F.E.R.C.*, 671 F.2d 119 (5th Cir. 1982). In that case, this Court held that the Commission could require a negotiated contract term as a prerequisite to a seller's collection of a Section 107(c)(5) incentive price. In so requiring, the court held that the Commission did not improperly interpret the contract in derogation of the parties' right embodied in Section 101(b)(9) of the NGPA, 15 U.S.C. Section 3311(b)(9), to set gas prices by contract. 671 F.2d at 121. The 1982 *Pennzoil* case implies that the Commission has the corresponding power to state that particular contract language will not authorize a special rate. This is precisely what the Commission has done with respect to the area rate clause in intrastate gas contracts and the Section 110 allowances. We therefore reaffirm the Commission's power to establish eligibility requirements in cases of this type.

We turn now to the Producers' second attack on the Commission's handling of area rate clauses in intrastate contracts; that is, even assuming jurisdiction, the Commission acted arbitrarily in not treating sellers under an intrastate contract like similarly situated interstate sellers. The Pipelines and the Associated Gas Distributors counter that it was unreasonable to allow any amount for delivery vis-a-vis intrastate contracts, for essentially the same reasons discussed with regard to their broad attack on generic allowances.[29]

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29. *See* Part IIA, *supra*.
We find those contention equally meritless here.

In 15 C.F.R. Section 271.1104(d)(2), the Commission provided that a seller of intrastate gas would receive the amount for delivery as provided in its gas contract, unless it amends its contract to allow the collection of an amount for delivery "not to exceed an amount reasonably comparable to the Section 110 adjustments collected by similarly situated sellers" of interstate gas. No provision is made for the recovery of any other production-related cost. The Producers maintain that this approach violates the Congressional mandate in the NGPA that there be a single, uniform national gas market. The Commission does not dispute the importance of market uniformity as an NGPA objective; it does maintain, however, that uniformity is not the only policy. The Commission notes that prior to 1978, it lacked jurisdiction over sales of intrastate gas. As a result, it has no hard data on which to base a generic allowance for intrastate sellers. To this, the Producers respond that they provided data demonstrating that delivery allowances in the intrastate system should correspond exactly to the appropriate allowance for interstate gas.

Although the issue is close, we do not believe that the Commission behaved arbitrarily in this regard. The difference between the collection of a generic delivery allowance and the collection of an amount "reasonably comparable" to the generic allowance is relatively slight in this context. This is so, because in both cases the amount is merely a ceiling, subject to contractual limitation by the parties. We believe that the Commission's varying levels of confidence in the two sets of data involved justify this rather slight difference in treatment. Moreover, the Commission's decision to deny compression allowances to sellers under intrastate contracts similarly

finds adequate support in the record. The Commission's failure to establish a generic delivery allowance for intrastate gas and decision not to allow recovery of compression allowances via an area rate clause in an intrastate contract are therefore upheld.

III.

The second major issue in this case arises under the Declaratory Order issued pursuant to Title I of the NGPA. R. at 6852-69.[30] That order is directed to the applicability of the Title I maximum lawful price to a common situation in the gas industry. Very often, a producer-seller arranges contractually to have its own liquids and liquefiables[31] transported by the pipeline-purchaser along with the newly sold gas. The pipelines typically perform this service either gratis or at a greatly reduced rate. This practice becomes somewhat problematic where a producer receives both the maximum lawful price and the free or reduced-rate transporting of its liquids and liquefiables. Nonetheless, in its Title I Declaratory Order, the Commission held that these services received by the seller are not part of the price; therefore, the maximum lawful price provisions of the NGPA are not violated by a contract of the type described above.

The Pipelines, along with the Associated Gas Distributors, strongly object to this interpretation of the NGPA

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30. The Commission's denial of rehearing of that order, R. at 6984-7007, as well as order in *Texas Eastern Transmission Corp.*, 20 FERC ¶ 61,116, *reh'g denied*, 21 FERC ¶ 61,281 (1982), *reh'g denied*, 22 FERC ¶ 61,114 (1983), raise the identical issue and are also before this court.

31. Liquids are hydrocarbons that are produced, with the various gasses, in liquid condensate form. Liquefiables are gaseous hydrocarbons, other than methane, which are easily converted into liquids.

maximum lawful price provisions. They argue that the Commission's interpretation of the statute is contrary to Congress's intent that all valuable consideration be deemed part of the maximum lawful price. They further note that maximum lawful prices apply to first sales, Section 504(a) of the NGPA, 15 U.S.C. § 3414(a), and that sale is defined as "any sale, exchange or other transfer *for value*," Section 2(20) of the NGPA, 15 U.S.C. § 3301(20) (emphasis added). It follows, in their view, that, as the transporting of the liquids and liquefiables clearly constitutes value, the literal language of the NGPA is also ignored by the Commission's Order. The Pipelines also argue that this result is inconsistent with the history and structure of the NGPA. Finally, the Pipelines argue that prior practice under the Gas Act compels a different result.

The Commission, joined in large measure by the Producers, views the essential question somewhat differently. It maintains that regardless of the broad NGPA definition of "sale," the term "price" simply was not intended to include services of this type. In support of this, the Commission notes that it has long directed the pipelines to allocate the cost of these services away from the consumer; but if the pipeline chooses to provide this service at a reduced rate by contract and absorb the costs, the maximum lawful price provisions will not rescue it from its improvident contract. Moreover, this scheme frees the Commission from the endless chore of assigning a value to every aspect, every covenant, every warranty in a gas contract. In any event, the Commission urges that its interpretation of Title I is not unreasonable and should be sustained.

A.

Although the courts have the ultimate power of interpretting statutes, this Court generally accords "great deference" to the Commission in its interpretation of the NGPA. *See Union Texas Petroleum Corp. v. FERC,* 721 F.2d 146 (5th Cir. 1983). Nonetheless, in this case, the Commission's orders below admittedly raise serious questions. The most problematic of these is the specter of opening a gaping loophole in the maximum lawful price provisions in the NGPA. As the Pipelines argue, and with some force, there is considerable frailty in a definition of price that includes money and other tangible property but excludes services of unquestioned value.

On the special facts of this case, however, the order of the Commission can be sustained. This is so, because the Commission has had a longstanding policy of requiring that the pipelines not allocate these costs to the consumer in their rate proceedings. This has been accomplished either by allowing a pipeline to collect from the producer an additional amount over the wellhead price, as in the earlier scheme, or by empowering the pipelines to contract to provide this service below cost while prohibiting the recovery of these costs by the pipeline in their rate proceedings. It therefore does not seem unreasonable or inconsistent with the purposes of the NGPA to require the pipelines to adhere to their contracts, provided adequate protection of the above-described policy is assured. Moreover, we are unpersuaded that the Congress intended to require the Commission to consider this particular service as part of the price. Accordingly, we defer to the Commission's reading of the statute.

IV.

The third set of issues in this case arises from another aspect of the Title I liquid and liquefiables problem. The Commission, under its Gas Act jurisdiction, places conditions on the issuance of many certificates of public convenience and necessity to pipelines. *See* 15 U.S.C. § 717f (e). Many of those conditions provided, in general terms, that pipelines would not be allowed in their rate cases to allocate to consumers the costs incurred in transporting producer-owned liquids and liquefiables. The Commission based these conditions on its finding that consumers did not benefit from these costs.

Conditions of this type were attacked below by pipelines in *Trunkline Gas Co.*, 14 FERC ¶ 61,222 (1981), and, on rehearing, in *Transcontinental Gas Pipeline Corp.*, 222 FERC ¶ 61,029 (1983). The Commission declined to review those conditions but amended the certificates to make clear that they could be challenged later in the pipelines individual rate cases. R. at 7119-22, 7163. Other similar certificate conditions, now before this court, were also challenged. Subsequently, however, a settlement agreement between the pipelines and the Commission resolved this issue for a period of years.[32]

We are persuaded by the argument of the Commission and two of the pipelines that these orders are not yet ripe for our review. As the relevant settlement agreements lapse, the pipelines may decide to yield to the Commission's will, to reach another settlement, or to litigate the issue at that time. In any event, nothing that this Court

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32. The expiration date of the settlement agreements vary; however, none has yet expired.

might hold would have any immediate effect in view of the settlement agreements. Any opinion would be essentially an advisory one, dealing with what the legal rights of the pipelines *would* have absent the agreements. Such an opinion is plainly inappropriate.

We therefore hold that these orders are not yet ripe for review. It should be noted, however, and we explicitly hold that the pipelines should not be deemed to have waived their rights to challenge these orders by delaying their challenge to the rate case stage.[33]

V.

For the reasons outlined above, we affirm in substantial part, with the relatively minor exceptions noted in the text, the judgment of the Commission regarding the Section 110 issues, affirm in full as to the judgment of the Commission with respect to the Title I Declaratory Order issues, and hold that the certificate conditions issues are not yet ripe for review.

AFFIRMED IN PART; VACATED and REMANDED IN PART; DISMISSED IN PART.

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33. Indeed, the relevant settlement agreements make clear that no waiver is to be inferred. We emphasize this only to address the concerns of Certain Pipelines that such a waiver might later be found.

APPENDIX B

COMMISSION OPINIONS, ORDERS AND NOTICES

[¶ 61,013]

Indicated Producers—Shell Oil Company, *et al.*, In the Matter of the Transportation of Liquid and Liquefiable Hydrocarbons by Natural Gas Pipelines [RM 81-32], Docket No. GP82-50-000;

Associated Gas Distributors, Transportation by Natural Gas Pipelines of Producer-Owned Liquids and Liquefiable Hydrocarbons Under Title I of the Natural Gas Policy Act of 1978 [RM81-39], Docket No. GP82-51-000;

Texas Eastern Transmission Corporation, Transportation by Natural Gas Pipelines of Producer-Owned Liquids and Liquefiable Hydrocarbons [RM81-43], Docket No. GP82-52-000

Declaratory Order

(Issued January 17, 1983)

Before Commissioners: C. M. Butler III, Chairman; Georgiana Sheldon, J. David Hughes, A. G. Sousa and Oliver G. Richard III.

I. Background

This order addresses a common issue raised in the above-captioned dockets. When natural gas flows from a well, the gas stream typically includes substances other

than methane (the primary constituent of the gas delivered to natural gas customers).[1] In many cases, the producer reserves title to these substances and sells them to others after removal from the gas stream. A question arises over who pays for transportation and handling of the removed substances from the well to the point where they are removed from the gas stream. The issue addressed here is:

> Whether, in connection with any first sale of natural gas, where a pipeline-purchaser transports and handles removed substances on behalf of a producer-seller, the value of the transportation service received by the producer (or, alternatively, the cost incurred by the pipeline-purchaser in providing the transportation service) is included in the first sale price paid for the natural gas being sold; and whether, where the dollar-denominated first sale price paid plus the value of any such transportation of removed substances to the producer-seller (or, alternatively, the cost incurred by the pipeline-purchaser to provide such transportation service), less any charge paid by the producer for the service, exceeds the applicable maximum lawful price under NGPA Title I, the producer-seller would be considered in violation of NGPA Section 504(a).

This "Title I issue" is relevant to a number of related cases. First, the question of an appropriate cost apportionment methodology has been the subject of dispute in a number of interstate pipeline general rate pro-

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1. For the purpose of this order, the term "removed substances" includes some or all of the heavier liquid and liquefiable hydrocarbons, such as ethane, propane, butanes, and pentanes as well as non-hydrocarbon constituents such as helium to which a producer retains title under the terms of a gas purchase agreement.

ceedings.[2] Uncertainty over the Title I issue was one of a number of reasons attributed to the break-off of settlement conferences in those rate proceedings. Second, the Indicated Producers[3] filed a petition for a declaratory order in Docket No. GP82-50 on June 1, 1981, disclaiming the applicability of Title I of the NGPA to the transportation of removed substances by natural gas pipelines. Third, two petitions for declaratory orders filed by the Associated Gas Distributors (AGD), in Docket No. GP 82-51, and by Texas Eastern Transmission Corporation (Tetco) in Docket No. GP82-52, take the opposite view and seek an order finding that, where a pipeline-purchaser is transporting removed substances for the producer-seller, the cost of such transportation service is consideration which must be taken into account in determining whether the applicable statutory maximum lawful prices have been exceeded.[4]

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2. Tennessee Gas Pipeline Company, Docket Nos. RP80-97 and RP81-54, *et al.;* Michigan Wisconsin Pipe Line Company, Docket No. RP80-100; Southern Natural Gas Company, Docket No. RP80-102; Natural Gas Pipe Line Company of America, Docket No. RP80-107; Transcontinental Gas Pipe Line Corporation, Docket No. RP80-117; United Gas Pipe Line Company, Docket No. RP80-121; Trunkline Gas Company, Docket No. RP80-106; Columbia Gulf Transmission Company, Docket No. RP80-145; Columbia Gas Transmission Corporation, Docket No. RP80-146; Sea Robin Pipeline Company, Docket Nos. RP80-55 and RP80-118; Florida Gas Transmission Company, Docket No. RP81-7; High Island Offshore System, Docket No. RP81-18; U-T Offshore System, Docket No. RP81-20; Consolidated Gas Supply Corporation, Docket No. RP81-80; Transwestern Pipeline Company, Docket No. RP81-130; and Texas Eastern Transmission Corporation, RP81-109.

3. Shell Oil Company, Arco Oil and Gas Company, Conoco Inc., Gulf Oil Corporation, and Marathon Oil Company.

4. The three dockets involving the petitions for declaratory orders of Indicated Producers, AGD and Tetco are being consolidated here because the respective petitions raise almost identical issues with respect to the relationship of NGPA Title I price ceilings and the

II. Discussion

A. Statutory Construction

Title I of the NGPA establishes maximum lawful prices for the first sale of natural gas at the wellhead, or at any other locus of a "first sale."[5] The NGPA, therefore, expressly permits the seller in a first sale to sell raw, unprocessed natural gas[6] at the wellhead and collect the full maximum lawful price applicable to it, provided that the contract between the seller and buyer so permits. Section 504 of the NGPA makes it unlawful for any person to sell natural gas at a first sale price in excess of any maximum lawful price in Title I. Section 501 of the NGPA authorizes the Commission to administer the NGPA and define terms used in the Act. "Price," one such term used in the Act, is nowhere defined in the NGPA. The Commission's task in this declaratory order in large part amounts to ascertaining the intent of Congress in its use of the term "price" in Title I of the NGPA.

In approaching this task, the Commission will keep in mind the historical development of the NGPA and ex-

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transportation and handling of removed substances by pipelines for producers. To the extent that these pleadings also involve petitions for rulemaking, they will be addressed in the appropriate RM dockets.

5. The maximum lawful prices also apply in some instances to sales made beyond the wellhead. For example, a sale by a gas gatherer can be a first sale. *See* NGPA Section 2(21)(A).

6. NGPA Section 2(1) defines natural gas as it was defined in the NGA: "Natural gas' means either natural gas unmixed, or any mixture of natural and artificial gas . . ." This definition has been construed to mean the "mixture of gaseous hydrocarbons found in nature." *Deep South Oil Co. v. F.P.C.*, 247 F.2d 882, 888 (5th Cir. 1957). Thus the "natural gas" to which the Title I "prices" apply is the raw mix of naturally occurring gaseous hydrocarbons found at the wellhead. However, when a producer reserves title to the removed substances, only that portion of the gas stream which is sold is subject to Title I ceiling prices.

amine how gas purchase contracts are structured to reflect the mechanics of production. Issues raised in the petitions will be discussed and an interpretation of the sections of the statute relevant to the Title I issue will be undertaken in order to ascertain the intent of Congress.

The mechanics of natural gas production are such that methane as well as liquid and liquefiable hydrocarbons and non-hydrocarbon constituents, all may be part of the raw natural gas "product" that is produced at or near the wellhead. Because it would be uneconomical to have facilities at each well to separate the removed substances from the gas stream, a natural gas pipeline company will often transport the entire raw natural gas stream through its pipeline system, even though it might only have title to the methane component of the raw natural gas stream as it comes from the ground.

Gas purchase contracts reflect these economic and operational aspects of natural gas production, with the producer often reserving title to the removed substances and the pipeline company agreeing to transport the producer's liquid and liquefiable hydrocarbon components along with the gaseous component destined for the pipeline's market. This transportation service is of some value to the producer and the pipeline incurs some cost in providing it. This is of obvious relevance because Section 2(20) of the Act defines the term "sale" as a "transfer for value." Thus, it is argued that the receipt of this "value" by the producer, or the incurrence of this "cost"[7]

7. In their response to Tetco's petition, filed November 6, 1981, in Docket No. GP82-52-000 [RM81-43], AGD makes a careful distinction between the "value" of the transportation service to the producer as opposed to the "cost" of said service to the pipeline, saying the former is the measure of the consideration transferred to the producer, and not the latter, as asserted by Tetco. AGD Response

by the pipeline, is inconsistent with the Title I ceiling rates, if the producer collects the statutorily prescribed maximum lawful price in addition to the receipt of the service or value. After a careful analysis of all the petitions and comments, the Commission is of the view that neither the "value-received" nor the "cost-incurred" theory has any relation to Title I ceiling prices.[8] We wish to stress that this is a close question and a difficult determination to make. On balance, however, we cannot presume that Congress intended to implicate Title I prices with the transportation of removable substances provided for in gas purchase agreements. As we have seen in other contexts, Congress did not enact Title I on a blank slate, but in the context of prevailing practices under the Natural Gas Act.[9]

Typical producer-pipeline contracts *separately* cover items such as the price, quality, transportation, and so

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at 2. The Commission believes this is a distinction without relevance for the purposes of this order since we do not dispute that the transportation service is of value to the producers but only declare that this transportation service is not part of the "price" as the term is used in Title I. The measure of this consideration, therefore, whether on the basis of value received by the producer, or cost incurred by the pipeline, is irrelevant.

8. The March 4, 1981 order in *Trunkline Gas Company, et al*, Docket No. CP78-340, 14 FERC ¶ 61,222, has been misconstrued in some of the petitions and comments as addressing and disposing of the Title I issue; however, the order did not focus on the issue and the language referred to was merely a passing reference to the problem. The primary focus of the March 4, 1981 order was which forum was most appropriate for apportioning costs to liquids/liquefiables transportation. *See* Order on Rehearing, *Transcontinental Gas Pipe Line Corporation, et al.*, Docket No. CP79-70 *et al.*, issued January 18, 1983, 22 FERC ¶ 61,029, mimeo at 7.

9. *Compare, Ranes v. Office Employees Int'l Union, Local No. 28*, 317 F.2d 915, 918 (7th Cir. 1963). ("We must assume that Congress was aware of the established structure and practices [of labor unions] and interpret the statute in light thereof.")

forth, of the natural gas sold to the pipeline. Price is established in terms of dollars and cents; matters such as quality usually are not. Royalty and tax payments are also assessed on the dollar amounts stipulated as "price" in the contract—not as the sum of non-price "values" plus that price.

In support of their position that "price" in Title I includes the value or cost of transporting removed substances, AGD and Tetco cite[10] the Commission's Notice of Proposed Rulemaking, Docket No. RM80-52 (issued April 23, 1980),[11] which concerned the "advance payments" program, and proposed a carrying charge credit for interest received on advances. The notice, however, concerned the proper treatment of monetary advances to producers, and the interest thereon, (or more precisely, the time value of the monies advanced) and was not essentially different from a payment in dollars.

The NGPA was written in the context of a system of national producer rates adopted by the Commission under the Natural Gas Act.[12] Under the Natural Gas Act, the Commission regulated the rates and charges of both the

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10. AGD Petition filed July 22, 1981, at 3-4; Tetco Comments filed September 20, 1982, at 13. (Page unnumbered.)

11. *FERC Statutes and Regulations, Proposed Regulations* ¶ 32,063, 45 *Fed. Reg.* 28345 (April 28, 1980); 45 *Fed. Reg.* 35348 (May 27, 1980).

12. Opinion Nos. 699 and 699-H, 51 FPC 2212 and 52 FPC 1604, respectively (1974), *aff'd sub nom. Shell Oil Company v. F.P.C.*, 520 F.2d 1061 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976); Opinion No. 749, 54 FPC 3090 (1975), *reh. denied*, Opinion No. 749-C, 56 FPC 303 (1976), *aff'd in part and rev'd in part, sub nom. Tenneco Oil Co. v. F.E.R.C.*, 571 F.2d 834 (5th Cir. 1978), *cert. dismissed*, 439 U.S. 801 (1978); Opinion Nos. 770 and 770-A, 56 FPC 509 and 56 FPC 2698, respectively (1976), *aff'd sub nom. American Public Gas Assoc. v. F.P.C.*, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978).

producer and the purchasing interstate pipeline under Sections 4 and 5 of the Natural Gas Act. With respect to producer rates, the Commission's mechanism in its national rate regulations to account for additions or reductions to generic rates relating to the value or cost of gas quality activities undertaken was to permit adjustment pursuant to the terms of the contract between the pipeline and producer. Section 2.56a(c)(2). However, as the Supreme Court noted in *CATCO*,[13] our exercise of jurisdiction over producer sales under the Natural Gas Act must include an examination of cost responsibility for the transportation of removed substances regardless of the contractual provisions relating to that type of service.

With respect to the rates charged by pipelines to their natural gas customers, the Natural Gas Act entrusted to the Commission the responsibility to assure that only those costs properly attributable to natural gas consumers are reflected in jurisdictional rates. The cost allocation method of carrying out this obligation was effectively approved in *Mobil Oil Corp. v. F.P.C.*, 483 F.2d 1238 (D.C. Cir. 1973), where the court stated:

> We do not ignore the need to assure that users of gas are not asked to pay for the transportation of a commodity they are not using. We recognize that the Commission must have some mechanism to assure that injustice does not result. (483 F.2d at 1249).

The same opinion stated that "interests of the gas consumer could be adequately protected by allocating costs between the operations over which the Commission had jurisdiction and those which it did not." (483 F.2d at

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13. *Atlantic Refining Co. v. Public Service Comm'n of New York*, 360 U.S. 378, 393 (1959).

1247). Thus, since the *CATCO* and *Mobil* cases, this Commission has an unequivocal mandate to assure that natural gas ratepayers receive fair treatment when assigning cost responsibility for the transportation and handling of the producer's removed substances. Our March 4, 1981 order in *Trunkline,* and the certificate conditions imposed in numerous cases involving the transportation of removed substances, are a continuing part of this effort. Following the *Mobil* opinion, the Commission adopted cost allocation requirements as its means for protecting gas consumers. Commission policy under the Natural Gas Act was, in almost all cases, to leave the consideration to be paid for the transportation and handling of removed substances to private contractual negotiation between the parties,[14] but to rely upon its pipeline rate authority to assure that these costs would not be subsidized by natural gas customers. To the extent that the transportation service a pipeline may provide for a producer's removed substances is non-jurisdictional, the price paid for the transportation service is a matter of private contractual negotiation, while the cost allocated to the service is subject to Commission review.[15] The enactment of the NGPA did not alter the Commission's duty to protect natural gas consumers against bearing costs attributable to these activities. Nor did it alter the Commission's responsibility to employ its Natural Gas Act rate authority over interstate pipelines as the means to assure that natural gas consumers would not bear these costs. We do so *again*

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14. *See* §§ 2.56a(c) and (h), and 2.56b(d) and (i) of the Commission's regulations which implement the national rate opinions and leave any adjustments to the private contractual arrangement of the parties, except for Btu standards and gathering allowances.

15. Of course, to the extent that liquefiables remain in a gaseous state while transported. they are jurisdictional.

today. Because the removed substances question was addressed through pipeline rate regulation rather than through producer price regulation prior to the NGPA, the Commission cannot assume, in the context of regulation under the Natural Gas Act and the prevailing economic climate in 1978, that Congress intended "price" under the NGPA to be offset by the value or cost of the removed substance transportation service in a gas purchase contract. To do so would shift from pipeline to producer regulation at the very time that Congress was seeking to withdraw from the field of producer regulation.

Congress in the NGPA was turning away from the *Phillips* decision which had given the Commission the plenary authority to establish and adjust all interstate producer rates.[16] For example, Section 601(a)(1)(B), in fact, removes from our Natural Gas Act jurisdiction producer sales under contracts for natural gas covered by Sections 102(c), 103(c) and 107(c)(1), (2), (3) and (4). The NGPA, by substituting a Congressional "national rate" structure for the Commission's administrative structure, removes our authority to adjust maximum lawful ceiling prices downward.[17] Congress also deferred to the parties' contractual agreements to determine the price to be paid. *See* NGPA Section 101(b)(9). Therefore, we believe Congress has already balanced the equities in setting these rates[18] and a producer who receives lower-than-cost or even "free" transportation and handling of the removed

16. *Phillips Petroleum v. Wisconsin*, 347 U.S. 672 (1954).

17. Section 110 does permit *additions* to maximum lawful prices but only for certain production-related costs and state severance taxes "borne by the seller." Sections 104, 106 and 109 also contain express authority to set just and reasonable rates above the statutory levels.

18. *See* n. 24, *infra*, *Pennzoil Company v. F.E.R.C.*, 645 F.2d at 378.

substances is not, solely as a result of receiving this service, receiving a "price" in excess of the Title I maximum lawful prices so as to violate Section 504 of the NGPA.

The Commission is aware, as AGD points out in its July 22, 1981 petition, that NGPA Section 2(20) defines "sale" to include "any sale, exchange, or other *transfer for value.*"[19] (Emphasis added.) But the Section 2(20) definition is only a concomitant to Section 2(21) which defines "first sale"[20] and does not define the term "price," a term which is always used in conjunction with monetary consideration in the Act. The legislative history of the NGPA indicates that Congress intended the Commission to define terms such as "transfer for value" if it became necessary. (*See* n. 19, *supra.*) It is our view that the "transfer for value" is intended to determine when a "first

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19. The NGPA Conference Report states that "the Commission may define terms such as 'transfer for value' used in the definition of first sale . . ." H.R. Rep. No. 1752, 95th Cong., 2d Sess. 116 (1978).

20. If the legislative intent is not clear, the meaning of doubtful words in a statute may be determined by reference to their relationship with associated words and phrases under the rule of *noscitur a sociis.* Although this rule of statutory interpretation is commonly applied where there is a list of words or phrases so that the meaning of a word may be known or understood from the accompanying words in the group, we believe the rule is also applicable where similar words are defined in sequence, so that where a general term such as "sale" precedes and is associated with a more specific term such as "first sale," the general term is intended to be concomitant to, and take color from, the more specific term. Consequently, the term "sale" as defined in the NGPA is generally meant to be narrowly used as a concomitant to the term "first sale" for the purpose of determining whether the event that invokes Commission pricing jurisdiction under the NGPA (*i.e.*, a "first sale") has occurred. An indiscriminately broad use of the definition of "sale" in order to bootstrap non-monetary consideration, as a type of "transfer for value," into the dollar-denominated maximum lawful prices of Title I, would contravene this rule of construction. *See* 2A Sutherland, Statutory Construction, (4th Ed.), §§ 47.16, 47.17.

sale" triggering NGPA jurisdiction occurs, and is not meant to indicate that the "value" of the transportation and handling of removed substances should be considered part of the "price."

We believe that the teaching of the U.S. Court of Appeals, District of Columbia Circuit, in an opinion regarding a proposed definition of the term "process fuel" applies equally to the proposed novel denotation suggested by AGD and Tetco for the term "price" as used in Title I of the NGPA. *Process Gas Consumers Group v. United States Dept. of Agriculture*, 657 F.2d 459 (1981).

As the court stated:

> . . . it is difficult to see how Congress could have intended to use the term "process fuel" in the novel way [suggested] without providing somewhere—if not in the statute itself, at least in the legislative history—some indication that the term was being used to designate something other than that which previously had been designated by [it]. It is hard to believe that Congress wanted to adopt a novel denotation without anywhere giving an indication of that intent. 657 F.2d at 466.

The NGPA rests upon the prevailing industry practices rooted in the regulatory context that existed at its enactment. In short, the NGPA generally accepts the existent *status quo* of industry practices under the Natural Gas Act, and where a change was intended, Congress spoke clearly. The Commission finds, therefore, that where a pipeline transports removed substances on behalf of a producer-seller, this neither breaches directly nor circumvents indirectly the maximum lawful price ceilings of Title I in violation of Section 504 of the NGPA. While the trans-

portation service is consideration flowing to the producer, it is not part of the "price" for his natural gas.[21]

Although Congress vested the Commission with authority to prescribe higher ceiling prices in some instances, the NGPA made clear that the Commission did not have power to lower ceiling prices.[22] NGPA prices are deemed "just and reasonable" under Sections 4 and 5 of the Natural Gas Act.[23] Therefore, when a producer has contractural authority to charge and collect the applicable NGPA ceiling price at the wellhead, receipt of that price, having been Congressionally authorized, is deemed just and reasonable and is not subject to reduction by the Commission.[24] By requesting that Title I ceilings be offset

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21. The Commission is aware of the possibility that unusual contractual arrangements could be structured solely for the purpose of evading the Title I price ceiling. For example, a contract might be drafted to provide that in addition to the maximum lawful price in dollars, the seller was to receive one share of X company stock per MMBtu delivered, or a certain amount of a precious metal, or gemstones—all these non-dollar elements of consideration are clearly devices to circumvent the ceiling "price." These examples are given to illustrate that such unusual contractual arrangements could violate the Title I maximum lawful prices. Such a manifestly deceptive pricing arrangement is regulated more properly by application of the Commission's enforcement powers under Section 504 of the NGPA. In addition, the Commission has the authority to prevent such circumvention pursuant to NGPA Section 601(c)(2) and passthrough of the improper payments could be denied to the purchasing pipeline.

22. *Compare,* NGPA Sections 104(b)(2), 106(c), 107(c)(5) and 109(b)(2) with Section 601(c). The NGPA also authorized the Commission to establish certain allowances for state severance taxes and certain production-related costs that "shall not be considered to exceed maximum lawful price." NGPA Section 110(a).

23. NGPA Section 601(b)(1).

24. "FERC has . . . a narrower authority to administer the NGPA and to prescribe *higher* price ceilings only in certain circumstances . . . The balance Congress struck already took into account the conflicting interests of producers and consumers." *Pennzoil Company v. F.E.R.C.*, 645 F.2d 360, 378 (5th Cir. 1981), *cert. denied*, 102 S. Ct. 1000 (1982).

by the value or cost of the transportation and handling of removed substances, petitioners AGD and Tetco are implicitly requesting that the Title I price ceilings be "reduced." The Commission finds that this request seeks to abrogate contractual agreements with the owners of the removed substances, and is based upon a misunderstanding of the NGPA and the historical backdrop that existed at the time the NGPA was enacted.

B. Administrative and Policy Considerations

The reasonableness of construing "price" as used in the NGPA to include only monetary consideration, as suggested by the Indicated Producers, is more apparent when the implications of construing it otherwise are examined. First of all, for every producer first sale the Commission would have the extraordinary difficult task of determining the value of the transportation service received by the producer to determine whether this amount, when added to the monetary consideration, exceeds the applicable Title I maximum lawful price. This flies in the face of the policy decision made by Congress that NGPA ceiling prices are not to be cost-based.[25]

It would be extremely difficult to determine what the value equivalent of each transportation service was in

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25. The legislative history is clear on this point:

> . . . the Commission's administrative chores under the pricing provisions of the NGPA are fundamentally different from those under the Natural Gas Act . . . the Commission will no longer inquire into producer costs . . .

Letter of September 8, 1978, from Chairman Charles Curtis to Senator Henry M. Jackson, at 12.124 (Cong. Rec. H13127 at 14 (1978). (*But see* NGPA sections 104(b)(2), 106(c), and 109(b)(2)). *See also, Columbia Gas Development Corp., et al. v. F.E.R.C.*, 651 F.2d 1146, 1159 n.15 (5th Cir. 1981). ("Except when setting prices in excess of the statutory ceilings, FERC no longer inquires into producer costs . . .".)

dollars under each gas purchase contract that required such services. AGD concedes that this process would be "extraordinarily complex" and that allocation of the relevant pipeline transmission costs would be a "more manageable surrogate."[26] Of course, such cost allocations are subject to Commission review and approval in each pipeline general rate case under the Natural Gas Act. But reliance upon that allocation for the purpose of a "reduction" in the NGPA Title I ceiling prices will not provide the certainty necessary to apply statutory ceiling prices. For example, if a purchasing pipeline contracts with a producer to pay the maximum lawful price for gas from a well remote from its system, and this gas is delivered to the purchasing pipeline by a second pipeline, then the ceiling price would have to be adjusted each time the *second* pipeline determined a new allocation in its rate case. Thus, the statutory interpretation advanced by AGD and Tetco would remove the certainty which results from the use of the dollar consideration to be paid for gas under the contract and the statute and would exchange that certainty for the shifting outcomes of cost allocaion determinations reached in a multitude of individual pipeline rate cases.

Carried to its logical conclusion, AGD's and Tetco's theory would not only make ceiling prices subject to the outcome of a variety of general rate cases involving transportation of removed substances, but would require that the Commission assign a dollar value or cost to *all* the separate non-price aspects of the relationship between a gas producer and its buyer. Under AGD's and Tetco's reading of the NGPA, all non-monetary considerations—whether flowing from the seller or flowing from the buyer

26. AGD Petition filed July 22, 1981, at 6.

—(not just the transportation of removed substances) would have to be assigned a value. Only after the total "cost" or "value" of *all* services and considerations performed by the seller and the buyer were computed, could the net consideration paid for the gas be compared with the Title I maximum lawful price. This massively complex system of costing and valuing every quantum of consideration was plainly not intended by Congress which generally sought in Title I to spur production by setting non-cost-based, incentive ceiling prices at the wellhead. The legislative history of the NGPA shows that Congress sought to avoid uncertainty and delay by generally pricing gas at the wellhead in simple dollar amounts.[27] More specifically, the legislative history of the NGPA shows the maximum lawful price was for the gas at the wellhead, without any offset.[28]

It is a mixim of statutory construction that each part or section of a statute should be construed in connection with every other part or section so as to produce a har-

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27. "The uncertainties associated with lengthy judicial review of Federal Power Commission wellhead price determinations are avoided by use of a statutorily established maximum lawful price. Regulatory lag and other problems associated with reliance upon historical costs to establish just and reasonable wellhead prices are similarly avoided." *National Energy Act*, H.R. 6831, H. Rept. No. 496, Part 4, 95th Cong., 1st Sess. 97 (July 29, 1977).

28. The following colloquy illustrates this point:
Sentator Gravel: Senator, I infer that the permissive nature of the Commission's power to provide, by rule or order, an allowance in excess of the maximum lawful price for any costs of gas conditioning borne by the Seller beyond the wellhead does not preclude a purchaser from acquiring natural gas at the wellhead, paying the maximum lawful price at that point.
Senator Jackson: The Senator is correct.
124 Cong. Rec. S16257 (Sept. 27, 1978).

monious whole.[29] The construction that produces the greatest harmony and the least inconsistency is that which ought to prevail.[30] An examination of other sections of the NGPA vis-a-vis the construction of Title I maximum lawful prices put forward by the various petitioners reveals that the construction advanced by Indicated Producers is most harmonious with the rest of the statute.

Section 203(b), for example, in Title II of the NGPA provides that for purposes of incremental pricing, the "first sale acquisition cost" of natural gas is "the price paid." There is no indication that any netting-out of the value of non-monetary consideration flowing to and from buyer and seller was envisioned to adjust the dollar amount of incremental pricing surcharges. The Commission has implemented Title II based only on dollars paid and no one has appealed this implementation[31] on the basis that it is error to exclude the cost or value of transportation and handling of removed substances. In fact, to include such adjustments in the already intricate incremental pricing calculations would make implementation of that program, for all practical purposes, unworkable.

Perhaps the most telling absurdity involves Section 601(c) when interpreted in light of the value-added theory. Prior to the NGPA, the Commission had the obligation under the Natural Gas Act to protect consumers by apportioning costs between jurisdictional and non-jurisdictional services and assuring that jurisdictional

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29. 2A *Sutherland, Statutory Construction,* § 46.05, (4th Ed.) at 56.

30. *Id.* at 57.

31. Order No. 49, Docket No. RM79-14, 44 Fed. Reg. 57726 (October 5, 1979) as amended by Order No. 49-A, 45 Fed. Reg. 767 (January 3, 1980) [*FERC Statutes and Regulations* ¶ 30,085, ¶ 30,114].

ratepayers would not bear costs which are attributable to non-jurisdictional services.[32] This principle remains true under the NGPA, where interstate pipelines' general rate cases continue to serve as the forum for such cost allocations. However, the NGPA did significantly restrict the Commission's pipeline rate inquiry in one significant respect. Section 601(c) sought to prohibit "back-door regulation" of wellhead prices by guaranteeing passthrough of any amounts actually paid to producers (in the absence of fraud, abuse, or other similar grounds.) Under AGD's and Tetco's reading of the NGPA, if the value or cost of the transportation and handling of removed substances was part of the "price," then such value or cost is guaranteed passthrough under Section 601(c) because it is deemed "just and reasonable" as part of the *"amount paid"* under Section 601(c)(1). Under Section 601(c), pipelines would have a guaranteed right to pass through such value or costs in the form of higher rates, especially after categories of gas become deregulated after 1985.[33] Such guarantees would apply even if the Commission found the service to be properly apportioned to non-jurisdictional customers. As these inconsistencies in connection with other sections of the NGPA show, Congress did not intend the value or cost of the transportation of liquids and liquefiables to be subject to regulation as part of the "price" paid for the gas.

III. Conclusion

There is legal argument to support both sides of this controversy, which is an important case of first impression

32. *Mobil Oil Corp. v. F.P.C.*, 438 F.2d 1238 (D.C. Cir. 1973); *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378 (1959).

33. NGPA Section 121, 15 U.S.C. § 3331.

for the Commission.[34] We find, after careful consideration, that the Indicated Producers' position is the stronger for several reasons. For one thing, the NGPA can only be understood in the regulatory context that surrounded its enactment. Reading Title I's maximum lawful prices to include only the "amount paid" in money for gas is most harmonious with the rest of the statute, particularly Section 601. A contrary interpretation results in extraordinary difficulties of administration and appears to contravene Sections 4 and 5 of the Natural Gas Act. The legislative history supports the view that Congress has already balanced the equities in setting Title I ceiling prices, which, if contractually authorized, the Commission has no authority to reduce. Finally, the Congress has given the Commission explicit authority to administer the Act and refine the definitions of terms therein. We believe the refinements adopted in this order are the most consistent with and "appropriate to carry out [our] functions under this Act." NGPA Section 501(a).

Our conclusion leaves the Commission with authority to perform a cost apportionment between the transportation and handling of natural gas and removed substances in interstate pipeline rate cases. Those costs attributable to the removed substances will not be borne by natural gas ratepayers. Instead, the responsibility of these costs will be assigned between the producers and the pipeline shareholders based upon private contract and state law.

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34. The Commission's passing statement in the *Trunkline* order can be misconstrued to support the AGD and Tetco positions only if Title I is examined in isolation from the rest of the statute and the historical context that surounded its enactment. The March 4, 1981 *Trunkline* order was not focused on the Title I issue.

IV. Intervention and Other Motions

Notice of the three petitions for declaratory orders was issued August 19, 1982 (47 *Fed. Reg.* 37615, August 26, 1982). Motions to intervene were timely filed by American Public Gas Association, Aminoil USA, Inc., Amoco Production Company, Ashland Exploration, Inc., Associated Gas Distributors, Colorado Interstate Gas Company, Columbia Gas Transmission Corporation and Columbia Gulf Transmission Company, Conoco Inc., Consumers Power Company, Exxon Corporation, General American Oil Company of Texas, Getty Oil Company, Hunt Oil Company, Interstate Natural Gas Association of America (INGAA), Kerr-McGee Corporation, Marathon Oil Company, Michigan Wisconsin Pipe Line Company, Mobil Oil Corporation, Mobil Producing Texas & New Mexico Inc., Mobil Oil Exploration and Producing Southeast Inc., Montana-Dakota Utilities Company, Mountain Fuel Supply Company and Mountain Fuel Resources, Inc., Natural Gas Pipeline of America, Northern Natural Gas Company, Division of InterNorth, Inc., Panhandle Eastern Pipeline Company, Pennzoil Company, Pennzoil Producing Company and Pennzoil Oil & Gas, Inc., Phillips Petroleum Company, Placid Oil Company, Public Service Commission of the State of New York, Public Service Electric & Gas Company, Shell Oil Company, Shell Offshore, Inc., Southern Natural Gas Company, Superior Oil Company, Tenneco Oil Company, Tennessee Gas Pipeline Company, a Division of Tenneco Inc., Texaco Inc., Texas Eastern Transmission Corporation, Transcontinental Gas Pipe Line Corporation, Union Oil Company of California, United Gas Pipe Line Company, and Zapata Exploration Company. (Texas Eastern Transmission Company, Mara-

thon Oil Company, and INGAA concurrently filed motions to consolidate.)

No answer to the motions to intervene having been filed, the timely motions to intervene are granted by operation of Rule 214. Since the Commission deems a party in either Docket No. GP82-50-000, GP82-51-000, or GP82-52-000 to be a party in all three GP dockets, the motions to consolidate are effectively granted. An untimely motion to intervene was filed by Sun Exploration and Production Company. Since no prejudice to existing parties will result from permitting the untimely intervention, and no answer in opposition has been filed, it is granted. Oneok Exploration Company filed a protest to the positions of Associated Gas Distributors and Texas Eastern Transmission Corporation. Pursuant to Rule 211, the protest is noted and was considered but will not make the protestant a party to the proceeding.

The additional comments filed by Texas Eastern Transmission Corporation are also noted and were considered. INGAA also has moved to consolidate its own petition for initiation of rulemaking and issuance of declaratory order, dated September 20, 1982, with the proceedings here. Insofar as INGAA's petition seeks a declaratory order as to whether Title I maximum lawful prices include the value of cost of removed substances transportation services, that issue alone is consolidated for resolution in Docket No. GP82-50-000, *et al.* As a final clarafication, the July 10, 1981 petition of Producer Petitioners is already considered consolidated with the other petitions for declaratory order in Docket No. GP-82-50-000, *et al.*

V. Findings and Order

The Commission finds:

In consideration of the foregoing discussion, the value or cost of the service performed by the pipeline-purchaser in transporting liquid or liquefiable hydrocarbons on behalf of a producer-seller is not a component part of the maximum lawful prices subject to regulation under NGPA Title I.

The Commission orders:

(A) The petitions for declaratory order of AGD and Tetco are denied; and

(B) The petition for declaratory order of Indicated Producers is granted.

(C) Docket Nos. GP82-50, GP82-51 and GP82-52 are consolidated. The INGAA petition of September 20, 1982, is also consolidated to the extent that it seeks a declaratory order on the Title I question.

APPENDIX C

COMMISSION OPINIONS, ORDERS AND NOTICES

[¶ 61,004]

Indicated Producers—Shell Oil Company, et al., In the Matter of the Transportation of Liquid and Liquefiable Hydrocarbons by Natural Gas Pipelines [RM 81-32], Docket No. GP82-50-001 through GP82-50-008;

Associated Gas Distributors, Transportation by Natural Gas Pipelines of Producer-Owned Liquids and Liquefiable Hydrocarbons Under Title I of the Natural Gas Policy Act of 1978 [RM81-39], Docket No. GP82-51-001;

Texas Eastern Transmission Corporation, Transportation by Natural Gas Pipelines of Producer-Owned Liquids and Liquefiable Hydrocarbons [RM81-43], Docket No. GP82-52-001

Order Denying Rehearing of Declaratory Order

(Issued July 7, 1983)

Before Commissioners: C. M. Butler III, Chairman; Georgiana Sheldon, J. David Hughes, A. G. Sousa and Oliver G. Richard III.

I. Background

On January 17, 1983, the Federal Energy Regulatory Commission ("Commission") issued a Declaratory Order in Docket No. GP82-50-000, *et al.*, 22 FERC ¶ 61,013

(1983) ("Declaratory Order"). The Declaratory Order addressed an issue raised in the above-captioned dockets:

> Whether, in connection with any first sale of natural dles removed substances[1] on behalf of a producer-dles removed substances[1] on behalf of a producer-seller, the value of the transportation service received by the producer (or, alternatively, the cost incurred by the pipeline-purchaser in providing the transportation service) is included in the first sale price paid for the natural gas being sold; and whether, where the dollar-denominated first sale price paid plus the value of any such transportation of removed substances to the producer-seller (or, alternatively, the cost incurred by the pipeline-purchaser to provide such transportation service), less any charge paid by the producer for the service, exceeds the applicable maximum lawful price under NGPA Title I, the producer-seller would be considered in violation of NGPA Section 504(a).[2]

22 FERC ¶ 61,013 at 61,021 (1983). The Commission answered the question in the negative.

On February 16, 1983, Associated Gas Distributors ("AGD"), Texas Eastern Transmission Corporation ("Tetco"), Transcontinental Gas Pipe Line Corporation ("Transco"), Tennessee Gas Pipeline Company, a Divi-

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1. In this order we shall use the term "removed substances" to include some or all of the heavier liquid and liquefiable hydrocarbons, such as ethane, propane, butanes, and pentanes, as well as non-hydrocarbon constituents such as helium, to which a producer retains title under the terms of a gas purchase agreement.

2. At page 2 of AGD's November 6, 1981 response to Tetco's petition, filed in Docket No. GP82-52-000, AGD proposes that the measure of the transportation service be on the basis of value received by the producer, rather than cost incurred by the pipeline, as proposed by Tetco. It is for this reason that the issue was stated alternatively, in terms of "value-received" or "cost-incurred."

sion of Tenneco Inc. ("Tennessee"), Michigan Wisconsin Pipe Line Company ("Michigan Wisconsin"), and Southern Natural Gas Company ("Southern Natural") filed timely requests for rehearing[3] of the Declaratory Order. Those who have requested rehearing have put forward certain allegations regarding the historical background and statutory interpretation that were discussed in the Declaratory Order, and have made other arguments to support a different result from that of the Declaratory Order.

By this order, the Commission denies rehearing for the reasons given below.

II. Discussion

Introduction

This discussion will concisely address the questions raised by the requests for rehearing. The issues raised with respect to the Declaratory Order and discussed *seriatim* below involve the proper interpretation of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301-3432 (Supp. V 1982); the application of contract law principles; the historic practice prior to the NGPA; allegations that the petitioners' position has been misconstrued; that circumvention of the maximum lawful price ceilings of the NGPA is now possible; and that a generic rulemaking proceeding on this issue is required.

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3. On February 17, 1983, Interstate Natural Gas Association of America ("INGAA") filed a request for rehearing one day out of time. Also on that date, Pennzoil Company, which had filed a timely request for rehearing, withdrew its request. INGAA's late-filed request is being treated as a petition for reconsideration so that the issues raised by INGAA, many of which were incorporated into other of the timely filings, will be considered. On May 20, 1983, INGAA filed a revised corrected version of its request.

The requests for rehearing also allege that evidence in certain pipeline rate proceedings somehow conflicts with the finding of the Declaratory Order, and that the Commission erred in its view that the petitioners' interpretation of Title I was administratively impracticable. Finally, a number of miscellaneous arguments are touched upon, which allege, among other things, a purported conflict with positions taken in other proceedings before the Commission, and an alleged "squeeze" on certain pipelines arising out of the Declaratory Order.

A. Statutory Interpretation

Section 504 of the NGPA makes it unlawful for any person to sell natural gas at a first sale "price" in excess of the applicable Title I maximum lawful price. The problem as stated in the Declaratory Order in large part amounts to ascertain the intent of Congress in its use of the term "price" in Title I.[4] Although the "prices" of Title I are to apply to any "first sale" of natural gas, as defined in NGPA section 2(21), "price" is not defined in NGPA section 2.

A number of the petitioners assert that the Commission's statutory construction of the term "price" is too narrow,[5] particularly in view of the inclusion of the term "transfer for value" in the NGPA's definition of "first sale." However, even with respect to the term "transfer

4. *See* Declaratory Order, 22 FERC ¶ 61,013, at p. 61,021 (1983).

5. *See, e.g.*, Tennessee Request at 3, 5; Transco Request at 7. Transco also avers that the Commission erred in holding that the question presented in this case involves an interpretation of Congress' intent in using the term "price" in Title I of the NGPA, and says that the issue is really only a contract law question. We continue to believe, however, that the matter essentially involves interpretation of the NGPA. [Hereinafter a Request for Rehearing of the Declaratory Order will be cited: "Request at."]

for value."[6] the Congress, in its crafting of the NGPA, has explicitly left it to the Commission to determine what constitutes a transfer for value.[7] The mere fact that a service is of value does not necessarily mean either that it constitutes a "transfer for value," for purposes of determining whether a first sale has occurred, or that it must be included in the "price" for purposes of determining whether the maximum lawful price has been exceeded.

Transco characterizes the Commission's interpretation as an attempt "to 'end run' the *clear meaning* of Congress. . . ."[8] (emphasis added). We believe it would be more accurate to say that the meaning is far from clear in this case, but that what the Congress did regarding the meaning of "price" and, for that matter, any other unforeseen problems arising out of administration of the NGPA (*see, e.g.*, NGPA section 501) was to give the Commission authority to fill in the interstices of the Act. Transco asserts that the Commission's position is faulty because, it says, there are "situations where a 'transfer for value' does not trigger NGPA [first sale] jurisdiction . . ."[9] But the example given is simply the result of the statutory exclusion of NGPA section 2(21)(B) which

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6. *See* Declaratory Order, 22 FERC ¶ 61,013 at p. 61,023 (1983).

7. The NGPA Conference Report states that "the Commission may define terms such as 'transfer for value' used in the definition of first sale. . . ." H.R. Rep. No. 1752, 95th Cong., 2d Sess. 116 (1978).

8. Transco Request at 7.

9. *Id.* In its request for rehearing Transco also notes that in the Declaratory Order, the Commission states that Congress intended the Title I prices apply to "gas at the wellhead, without any offset. (Declaratory Order, mimeo, at 14)." Transco seizes on this phrase and tries to imply that by it the Commission means the "site of the first sale" and not the contract of the parties is to be the primary determinant of the price that can be received. (Transco Request at

generally operates to prevent downstream sales by pipelines, local distribution companies and affiliates thereof from becoming first sales. This is a statutory exclusion which in no way interferes with the Commission's discretion to define the term "transfer for value" which is closely tied to the term "first sale," which is the jurisdictional keystone of the NGPA.[10]

B. Contractual Issue—Consideration

Transco and certain other petitioners attempt to couch the Title I question as involving contract law only.[11] One cannot look at the contract issues here apart from the statute, however, for what is essentially the issue here is a question under the NGPA: whether the removed substances transportation service should be quantified as part of the price for natural gas under the NGPA. Consideration itself is an amorphous concept that eludes definition.[12]

4.) As we stressed in the Declaratory Order, we agree that the contract of the parties is the determinant of the price to be paid for the natural gas and of any ancillary arrangements such as liquids and liquefiables transportation. The language quoted was merely intended to show that the producer, under the NGPA, need not treat, process, or otherwise modify the raw gas as it comes from the well (such as by stripping out liquids and liquefiables) before he can collect the maximum lawful prices of Title I.

10. *See* NGPA section 2(21).

11. Transco Request at 6-7; AGD Request at 2, 4-5; Tennessee Request at 7-8.

12. *See generally* 1 CORBIN, CONTRACTS, § 109. *See also* Calamari & Perillo, CONTRACTS, (2nd ed. 1977) Ch. 4 at 134, n.10. "Learned Americans are still engaged from time to time in valiant efforts to reduce the common-law rules of contract, and the doctrine of consideration in particular, to strict logical consistency. Legal rules exist not for their own sake, but to further justice and convenience in the business of human life; dialectic is the servant of their purpose, not their master." [Citing Pollock, Principles of Contract x-xi (9th ed. 1921).]

However, all the contract hornbook wisdom there is will still give no clear guidance on how to interpret "price" as used in the NGPA. In other words, the Title I issue essentially involves the interpretation of the complex regulatory scheme of the NGPA, and the meaning of the term "price" in the context of that statute.[13]

C. Historical Context

Certain petitioners have cited the Southern Louisiana Area Rate Proceeding[14] the proposition that the removed substances transportation service is part of the price paid by the purchasing pipeline for its gas.[15] However viable this view may have been under that particular proceeding, it is of no consequence after enactment of the NGPA and the national rate scheme which that statute confirmed.

In *Southern Louisiana,* the Commission permitted producers in the southern Louisiana area to collect the full ceiling price under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717-717w (1976 and Supp. IV 1980) for natural gas only if the applicable contract required the producer to pay a charge for liquefiables transportation of .02 cents per Mcf per mile and for liquids of 20 cents per barrel. These rates were set forth in § 154.105 of the Commission's regulations. 18 C.F.R. § 154.105 (1982).

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13. It has been held, in fact, that contractual provisions must give way to statutory enactments in the natural gas area. *See Energy Reserves Group v. Kansas Power & Light,* No. 81-1370, slip op. at 11, U.S., January 24, 1983. (State has authority to adjust and determine parties' contractual rights given the fact that parties are operating in heavily regulated natural gas industry).

14. Opinion No. 598, 46 FPC 86 (1971), *aff'd sub nom. Placid Oil Company v. F.P.C.,* 483 F.2d 880 (5th Cir. 1973), *aff'd sub nom. Mobil Oil Corporation v. F.P.C.,* 417 U.S. 283 (1974).

15. *See, e.g.,* AGD Request at 7; Tennessee Request at 6; Transco Request at 5, n.3; Tetco Request at 9-10.

This procedure was, however, limited to the southern Louisiana area and is not indicative of the context in which the NGPA was enacted. As stated in the Declaratory Order, the area rate system had already given way to a system of *national* producer rates at the time the NGPA was written.[16] And, under the national rate system, any adjustment to the generic rate ceilings was permitted *pursuant to the contract between the pipeline and the producer.*[17]

Moreover, 18 C.F.R. § 154.105 (1982) sets forth, by its own terms, the time period during which the southern Louisiana area rates which it established were intended to remain in effect. There is no basis to believe that since the "base area rates" set forth in § 154.105(a) were to expire no later than October 1, 1977, that the rates for the transportation of liquids and liquefiables in § 154.105 (i) were to remain in effect after that date. The provisions of § 154.105(e) and (i) were intended to apply to southern Louisiana area rates only. The other provision with similar rates was § 2.71. Section 2.71 was promulgated in Order 449 [47 FPC 208], 37 *Fed. Reg.* 2,957 (1972), which was reversed and remanded by the court in *Mobil Oil Corp. v. F.P.C.*, 483 F.2d 1238 (D.C. Cir. 1973). Since 1973, § 2.71 has been a legal nullity. However, after the *Mobil* opinion, some pipelines have elected to use, and the Commission has accepted, the unit amounts contained in that order in pipeline rate cases when com-

16. Declaratory Order, 22 FERC ¶ 61,013, at p. 61,022 (1983).

17. *See* 18 C.F.R. §§ 2.56a and 2.56b (1982). The Commission is aware that these regulations relate to *quality* adjustments and not specifically to the transportation and handling of removed substances. By logical extension, however, the proposition evidenced by the cited regulations—that the contract of the parties governs their relationship under the national rate system—applies to the transportation and handling of removed substances as well.

puting a credit to the pipeline's cost of service.[18] Such credits were undertaken by pipelines because the Commission would not permit natural gas ratepayers to bear the cost of the transportation and handling of removed substances, from which they did not benefit. However, these unit amounts were *not* used by the Commission to determine whether or not producers were complying with applicable national rates for wellhead prices.

One petitioner attacks the Commission's reliance on *Mobil Oil Corp. v. F.P.C.*, 483 F.2d 1238 (D.C. Cir. 1973) and *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378 (1979), because these cases arose in the context of producer price regulation.[19] But the proposition for which these cases were cited—that we must shield gas customers from costs not properly allocable to them—is equally valid in the context of pipeline regulation.

D. Misconstruction Allegation

Some petitioners have stated that the Declaratory Order misconstrues their argument.[20] The alleged misconstruction arises out of the following language in the Declaratory Order:

> . . . *when a producer has contractual authority to charge and collect the applicable NGPA ceiling price* at the wellhead, receipt of that price, having been

18. Many pipelines have conditioned their contract for removed substances services on Commission approval of the costs, with contractual provisions for payments by the producers to operate in the event of Commission disapproval of the passthrough of such costs.

19. Tetco Request at 16.

20. AGD Request at 2-3; Tetco Request at 17-18; Transco Request at 9-10.

> Congressionally authorized, is deemed just and reasonable and is not subject to reduction . . . By requesting that Title I ceilings be offset by the value or cost of the transportation and handling of removed substances, petitioners AGD and Tetco are implicitly requesting that the Title I price ceilings be "reduced."
>
> 22 FERC ¶ 61,013 at p. 61,023 (1983) (emphasis added).

It is now argued that this "mischaracterizes the thrust of AGD's and Tetco's argument as 'requesting that Title I ceilings be offset by the value or cost of the transportation and handling of removed substances. . . .' "[21]

While there is no "reduction" to the maximum lawful ceiling prices, as a practical matter, to the extent that gas purchase contracts authorize the producer to collect the Title I ceiling price, a reduction in the contract price would be equivalent to a reduction in the Title I maximum lawful ceiling price.

Thus, more precisely stated, the petitioners' argument is that the amount paid the producer for the natural gas would have to be reduced by the cost or value of the liquids and liquefiables services performed by the pipeline.

This would indeed effect a reduction in the price paid for the natural gas if the consideration taken into account was not for the natural gas proper, but instead was a separate matter related to the arrangement for the transportation and handling of the producer's liquids and liquefiables. In other words, the NGPA ceiling prices relate to the purchase of the natural gas stream, not to any services related to the liquids and liquefiables en-

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21. *See, e.g.,* Transco Request at 9, n.6.

trained therein. The consideration related to those services is separate from the purchase of the gas and is simply one of the many threads that make up the skein of the parties' agreement. By attempting to apply this separate incident of the contract to the price of the natural gas stream, the petitioners implicitly seek an adjustment downward in the dollar amount paid under the contract (generally at the maximum lawful ceiling level) for the natural gas, thereby abrogating the contractual agreements with the owners of the removed substances.

E. Circumvention Possibility

The "Title I issue" presents difficult regulatory alternatives: on the one hand, whether to allow every nuance of consideration in a gas purchase contract to be weighed under the "price" term, thereby removing certainty from the Title I pricing system; and, on the other hand, whether a reading of Title I prices, as ultimately found in the Declaratory Order, would create a risk of deceptive forms of price compensation.[22]

There is really only one choice possible: an interpretation of Title I that provides certainty of pricing. This is consistent with the intent of Congress and most appropriate to carry out the Commission's functions under the NGPA. The other alternative would not have furthered these purposes and would have resulted in a massively complex, if not unenforceable, system of costing and valuing every quantum of consideration in thousands of gas purchase contracts.

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22. *See, e.g.*, Transco Request at 10, and at 5, n. 2; Tenneco Request at 9; Michigan Wisconsin Request at 2; INGAA Request at 4, and Parts VI and VIII, at 6-10.

Certain petitioners state that the hypothetical examples of deceptive pricing arrangements (*e.g.*, involving stock, gems, or metals)[23] are indistinguishable from the contractual arrangements for the transportation and handling of removed substances.[24] This is not so. The removed substances arrangements are a traditional part of pipeline-producer contracting practices. The hypothetical examples, such as the transfer of stock or metals as part of the price for natural gas, are not the sort of pricing arrangement typically found in a gas purchase contract. These examples are simply meant as a caution not to read the Declaratory Order too broadly. Of course, the gamut of possibilities cannot be addressed in the abstract but only as concrete cases present themselves, as in the subject concrete case involving pipeline transportation of removed substances.

F. Necessity of Generic Rulemaking

Various petitioners allege that the Commission erred in not instituting a generic rulemaking proceeding to resolve the removed substances cost allocation questions which are related to the Title I issue.[25]

The allegation that it was an error for the Commission not to institute a generic rulemaking proceeding on the allocation issue is misplaced in a request for rehearing

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23. *See* Declaratory Order 22 FERC ¶ 61,013 at p. 61,027 (1983): ". . . a contract might be drafted to provide that in addition to the maximum lawful price in dollars, the seller was to receive . . . stock . . . or . . . precious metal, or gemstones . . . clearly devices to circumvent the ceiling 'price'."

24. *See, e.g.*, Transco Request at 5.

25. Southern Natural Request at 3-4; Tetco Request at 4, 7, 26-27; Transco Request at 11-12, INGAA Request at 7-8; Tennessee Request at 10-11.

of the Declaratory Order in GP82-50, *et al.* The original petitions for a declaratory order and a rulemaking, including, for example, the Tetco petition filed on September 15, 1981, were really two petitions under one cover—a petition for a declaratory order on the Title I issue, and a petition for a generic rulemaking on rates for the transportation and handling of removed substances. The Commission determined to treat the Title I issue in Docket No. GP82-50, *et al.*, and to reserve the related but separate petitions for a rule on transportation rates.[26]

However, the finding of the Declaratory Order that the transportation and handling of removed substances is not implicated in the Title I ceiling prices, once having been made, makes the necessity of a generic rule on the Title I issue unnecessary. Moreover, there is no need for a generic rule on cost allocation questions since these can be handled as they always have, in pipeline rate cases.[27]

Title V of the NGPA, particularly sections 501 and 502, gives the Commission broad discretion to administer the Act. It is well within the discretion of the Commission to simplify the administrative handling of such two-part requests by dealing with the declaratory order request in its own docket, and to reserve consideration of the sepa-

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26. Declaratory Order, 22 FERC ¶ 61,013 at p. 61,026 (1983). The three original petitions for rulemaking of Indicated Producers, AGD, and Tetco were assigned Docket Nos. RM81-32, RM81-39, and RM81-43, respectively.

27. In *Transcontinental Gas Pipe Line Corporation, et al.*, Docket No. CP79-70-000, *et al.*, Order on Rehearing, issued January 18, 1983, 22 FERC ¶ 61,029 (1983). We determined that pipeline rate cases were the proper forum in which to determine and allocate the costs of transporting and handling removed substances. Having decided to utilize the individual pipeline rate cases and not the general rulemaking approach, Texas Eastern's request for a rulemaking has been effectively denied.

rate request for rulemaking in the appropriate rulemaking docket. Tetco, for example, and others are attempting to substitute their notions of administration for the Commission's by asserting that a contemporaneous rulemaking and declaratory order proceeding are somehow required by the Administrative Procedure Act, 5 U.S.C. § 555(b) ("APA") in order to decide the issues they have raised.[28]

On April 21, 1983[29] and on May 18, 1983,[30] Orders Approving Settlements for eleven major pipeline rate cases have already resolved the issue that would have been the subject of the generic rule—the proper amount to allocate to a pipeline's cost of service for the transportation of liquid and liquefiable hydrocarbons.[31] Since

28. *See, e.g.*, Tetco's Request at 26. *See generally, Securities and Exchange Commission v. Chenery Corp.*, 332 U.S. 194, 202 (1947): ". . . any rigid requirement [of rulemaking as opposed to *ad hoc* determination] would make the administrative process inflexible and incapable of dealing with many of the specialized problems which arise."

29. *Trunkline Gas Company*, 23 FERC ¶ 61,137 (1983).

30. *Tennessee Gas Pipeline Company, et al.*, 23 FERC ¶ 61,233 (1983).

31. The central element of the settlements was the establishment of "Unit Amounts" which represent an allocation of the pipeline's cost of service to the transportation of liquids and liquefiable hydrocarbons. The Unit Amounts for wells connected on or before December 31, 1981 are: (i) for liquefiables 4.50 cents per Mcf per 100 miles . . . , (ii) for liquids, 55.00 cents per barrel . . . [and] for wells connected on or after January 1, 1982 . . . the Unit Amounts are: (1) for liquefiables, 10.25 cents per MMBtu per 100 miles transported offshore . . . and 3.10 cents per 100 miles transported onshore . . . , (ii) for liquids, $1.025 per barrel . . . if all of the transportation is onshore. *See, e.g., Trunkline Gas Co.*, Order Approving Settlement, Docket No. RP80-106-010, issued April 21, 1983 [23 FERC ¶ 61,137] mimeo, at 3-4. *Compare* 18 C.F.R. § 154.105(i). There is no need to commit manpower and resources to such a rulemaking project. Effective results have already been obtained by putting the burden of proof on the individual pipelines in their rate cases to show what the proper allocation of removed substances transportation and handling costs should be.

the issue is well on the way to being resolved in individual pipeline rate cases, a generic rulemaking would more likely *delay* rather than expedite resolution of the issues.

As for the allegations respecting our Interstate Commerce Act ("ICA") jurisdiction, nothing in the ICA, the NGPA, or the Natural Gas Act for that matter, mandates that the Commission exercise its authority in the form of a generic rulemaking to set rates if it believes a different approach is warranted.[32]

G. Administrative Impracticability

In the Declaratory Order the Commission listed a number of administrative considerations that supported its finding.[33] These considerations included: (1) the extremely difficult task of determining the cost/value equivalent of the removed substances services for many thousands of contracts;[34] (2) the fact that the "first sale acquisition costs" on which the incremental pricing program under Title II of the NGPA is based and all downstream surcharge amounts would have to be recalculated if AGD and Tetco's theory were to prevail; (3) that under AGD and Tetco's reading of the NGPA, after certain categories of gas became deregulated in 1985, it would not be possible to prevent passthrough of removed substances

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32. Section 402(b) of the Department of Energy Organization Act only vests the Commission with ICA authority "where the regulatory function establishes rates or charges for the transportation of oil by pipeline . . ." Department of Energy Organization Act § 402 (b), 42 U.S.C. § 7172(b) (Supp. V 1982).

33. Declaratory Order, mimeo, at 12-15, 22 FERC ¶ 61,013, at pp. 61,024-25 (1983).

34. Even AGD has stated that this process would be "extraordinarily complex". AGD Petition, filed July 22, 1981, in Docket No. GP82-51, at 6.

costs not properly allocable to gas customers, because these costs would be deemed part of the "amount paid" for the natural gas and guaranteed passthrough under NGPA section 601(c)(1); and (4) under AGD-Tetco's theory, *all* of the non-price aspects of the gas purchase contract, not just the transportation of removed substances, would have to be assigned a cost or value and then netted out to compare the resulting amount with the applicable Title I price. This would inject uncertainties into NGPA pricing which the legislative history clearly shows Congress wished to avoid. (*See* n. 40, *infra.*)

Certain petitioners have alleged that the Commission has overstated these administrative concerns;[35] that the implications for incremental pricing are unclear,[36] that the Commission's concern regarding section 601 is invalid;[37] and that the Commission's concern for certainty and simplicity of pricing under the NGPA reflects "the Commission's simplistic approach"[38] and not the intent of Congress.

Contrary to these assertions, we believe that the position taken in the Declaratory Order is most faithful to the ceiling price system established by Congress and that certainty of pricing was a very real concern of Congress when it enacted the NGPA. Our concerns are not, we wish to stress, simply matters related to convenience of administration. Rather, they are based upon the intent of Congress as found in the legislative history.

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35. AGD Request at 2, 6; Tennessee Request at 19; Transco Request at 10-11.

36. AGD Request at 7; Tetco Request at 19.

37. AGD Request at 8; Tetco Request at 18; Transco Request at 7-8.

38. AGD Request at 6. *See also,* Transco Request at 10.

Congress presumably was aware of the typical contractual arrangements regarding removed substances and struck a balance which took into account conflicting interests when it set the Title I price ceilings,[39] which were intended to be easily and simply ascertainable. If every contract term (*e.g.*, length of the contract, quantity of gas dedicated, liquids and liquefiables service) must be assigned a value or cost and then lumped under the rubric of price, then the certainty of the natural gas price which Congress established will be lost, and this Commission will be involved in "[t]he uncertainties associated with lengthy judicial review of . . . Commission wellhead price determinations,"[40] which Congress sought to avoid.

(1) Incremental Pricing

As for AGD's statement that its position has no implications for the incremental pricing program, we simply point out that since the acquisition costs subject to pass-through under the incremental pricing program are generally based on the "price paid in any first sale of natural gas,"[41] adoption of AGD's position would end any cer-

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39. *See Pennzoil Company v. F.E.R.C.*, 645 F.2d 360, 378 (5th Cir. 1981), *cert. denied*, 102 S. Ct. 1000 (1982): "FERC has . . . a narrower authority to administer the NGPA and to prescribe *higher* price ceilings only in certain circumstances . . . The balance Congress struck already took into account the conflicting interests of producers and consumers." Moreover, even assuming *arguendo* that the "value" of the transportation and handling of removed substances services is to be lumped under the heading of gas price, *what if this value to the producer far exceeds the applicable Title I ceiling price for the natural gas,* which may very well be the case in some instances. Congress could not have intended to preclude payment for the producer's gas in such cases. Instead, it was presumably well known to Congress that pipelines typically transported the producers' removed substances for them.

40. *See National Energy Act*, H.R. 6831, H. Rept. No. 496, Part 4, 95th Cong., 1st Sess. 97 (July 19, 1977).

41. NGPA section 203(b)(1)(A).

tainty of what the price paid was for purposes of establishing incremental pricing surcharges.

(2) Section 601

We believe that our observation regarding NGPA section 601(c) has also been misunderstood. We have already addressed the impact of section 601(c) in the Declaratory Order. 22 FERC ¶ 61,013 at p. 61,025 (1983). As we indicated there, section 601(c), contrary to AGD's (and others) assertions,[42] strongly supports the finding of the Declaratory Order, especially when the effect of deregulation of most categories of natural gas, which occurs in 1985, is considered. If the section 601(c) "amount paid" indeed includes the cost or value of liquids and liquefiables transportation service as petitioners allege, then *upon deregulation*, because the maximum lawful ceiling prices would cease to operate, this *entire* cost could automatically be passed through to gas customers of the pipeline, even though they may derive only a *partial* benefit from the transportation service, and even though the value or cost of the service may be *greater* than the cost of the gas. We cannot presume that this result could have been intended by Congress.

(3) Rate Case Is Proper Forum

The rate case is the proper forum to determine who benefits from the transportation and handling of removed substances, and how to apportion the value of these benefits. The Commission has not confused the NGPA cost

42. NGPA section 601(c)(2) provides that "the Commission may not deny any interstate pipeline recovery of any *amount paid* with respect to any purchase of natural gas . . ." (emphasis supplied). It is AGD's contention that the "amount paid" includes the provision of liquids and liquefiables transportation. AGD Request at 4.

passthrough issue with the cost allocation issue as suggested by AGD. What the Commission has done is determine that this cost allocation is to be done in a pipeline's rate case, and not by tinkering with what is to be included in the maximum lawful price ceilings of Title I, which would remove the pricing certainty Congress sought in the Title I prices.

H. Substantial Evidence—Benefits to Gas Customers

Certain petitioners, most notably Michigan Wisconsin and INGAA, assert that the Declaratory Order is not supported by substantial evidence in the record.[43] We believe the petitioners are only able to make such a claim by wrongly coalescing certain issues which must be kept discrete and separate in order to analyze the Title I question. These separate issues are:

(I) What "price" is the producer receiving for his *natural gas;*

(II) How much is the pipeline spending to transport and handle the producer's removed substances.

There is a subset to issue (II) however; namely, the two possible reasons for doing (II): either to benefit the producer, or to benefit the natural gas customer.

How the benefit to the producer and the benefit to the natural gas customers is apportioned is determined by cost allocation in a pipeline rate case.

It is in the pipeline rate cases that evidence on the issue of how the benefit to the producer and the benefit to the natural gas customers should be apportioned is put into the record.

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43. Michigan Wisconsin Request at 2; INGAA Request at 4, and at 7, n.4.

On the other hand, the Title I issue asks only whether the removed substances expenses of the pipeline *that were determined to benefit only the Producer*, are to be considered part of (I), the price the producer receives for his natural gas. Since this is chiefly a matter of statutory construction, no record evidence of the sort required to allocate the benefit to the pipeline from the benefit to the natural gas customers in the rate case is needed.

What Michigan Wisconsin, INGAA, and others may have done in asserting that the Declaratory Order was not based on substantial evidence is wrongly coalesce the rate case allocation issue with the Title I Declaratory Order issue.[44]

The Declaratory Order only goes to that part of the removed substances transportation and separation service that is properly allocable as a benefit *to the producer*, and whether that part should be quantified and deemed part of the price paid for the natural gas.

I. Other Proceedings

Certain petitioners have asserted that the Declaratory Order conflicts with other proceedings before the Commission.[45] These are: proceedings under NGPA section

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44. This is most evident in the following statement by INGAA:

The Order actually rests upon one of two assumptions:

a. that the transportation and/or separation of a producer's liquids and/or liquefiables by a pipeline conveys no benefit to gas consumers; or,

b. that such benefit which is provided is irrelevant.

In this proceeding there is no record evidence showing that gas consumers do not benefit . . . In addition there are cases now pending with record evidence and expert opinion to show benefits to gas consumers from such activities.

INGAA Request at 4.

45. *See, e.g.*, Tennessee Request at 4-5, 10, 12-13; Tetco Request at 12, 20, n.12 and at 21.

110, certain PGA (purchased gas adjustment) proceedings involving the "affiliated entities test" and other issues, and certain notices of proposed rulemaking.

(1) Order No. 94 Series,[46] and *Trunkline Gas Company,, et al.,* 14 FERC ¶ 61,222 (1981).

The allegation with respect to the Trunkline Gas Company order is not new and has already been addressed in the Declaratory Order. (*See* Declaratory Order, 22 FERC ¶ 61,013 at pp. 61,026-27).[47] With respect to these allegations, the pipelines are attempting to use provisions designed to protect natural gas ratepayers to protect instead their shareholders from unfortunate contracting practices. These and related orders place an emphasis on pipeline section 4 rate cases as the appropriate forum for determining cost allocations. Because certain costs will be allocated away from natural gas ratepayers, the public interest will be protected, and the Commission should not instead construe Title I in a manner which would dictate a particular assignment of cost responsibility between the producers and the pipeline shareholders.

Tennessee states (Tennessee Request at 4-5) that the Commision rules implementing section 110 of the NGPA

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46. [Reg. Preambles 1977-1981] *FERC Statutes and Regulations* ¶ 30,178 (1980). *See also* Order No. 94-A, *et al.* [FERC Statutes and Regulations ¶ 30,419] (1983).

47. "The March 4, 1981 order in Trunkline Gas Company, *et al.*, Docket No. CP78-340, 14 FERC ¶ 61,222, has been misconstrued in some of the petitions and comments as addressing and disposing of the Title I issue; however, the order did not focus on the issue and the language referred to was merely a passing reference to the problem. The primary focus of the March 4, 1981 order was which forum was most appropriate for apportioning costs to liquids/liquefiables transportation. *See* Order on Rehearing, *Transcontinental Gas Pipe Line Corporation, et al.*, Docket No. CP79-70, *et al.*, issued January 18, 1983 [22 FERC ¶ 61,029], mimeo at 7."

—Order No. 94, *et al.*—provide no allowance to producers for costs incurred to handle liquids and liquefiables which do not benefit gas customers. Accordingly, Tennessee claims the section 110 rules are inconsistent with the result of the Declaratory Order. There is no inconsistency.

The maximum lawful prices that are the focal point of both the Declaratory Order and the Order No. 94 series of rules are the prices set forth under sections 102 through 109 of the NGPA. Under the Declaratory Order, these prices are interpreted to exclude a pipeline's services in transporting a producer's liquids and liquefiables; under the rules implementing section 110, these prices cannot be lawfully exceeded to compensate a producer for performing services which do not benefit gas customers. (Just as, where the pipeline incurs costs, only those allocable to the gas purchaser are to be borne by the gas purchaser.) Rather than being inconsistent, these various determinations, viewed together, provide a uniform approach.

(2) Affiliated Entities Test.

NGPA section 601(b)(1)(E) provides for an "affiliated entities limitation" with respect to any first sale between any interstate pipeline and any affiliate of such pipeline. Tennessee asserts that in an "affiliated entities" proceeding,[48] Commission Staff has indicated a need to examine the favorableness of non-price provisions in gas purchase contracts to determine whether the pipeline has preferred an affiliated producer. This is purported to conflict with the Declaratory Order. The specific statutory limitation in NGPA section 601(b)(1)(E) is that the amount paid in any such first sale may "not exceed the

48. 21 FERC ¶ 61,004 (1982).

amount paid in *comparable* first sales between persons not affiliated with such interstate pipeline." (Emphasis added.) Thus, the statute imposes a "comparability" standard to determine whether a pipeline has preferred an affiliated producer, and the Commission Staff has comported with this statutory directive in specific cases by examining non-price as well as price provisions to determine whether affiliated transactions are "comparable" to non-affiliated transactions.[49] There is no conflict between looking at all incidents of a transaction to determine whether a transaction is truly *comparable* and the position taken in the Declaratory Order. It is one thing to say the various non-price incidents of a natural gas purchase agreement must be examined for a determination of the comparability of the transaction and quite another thing to assign a value to these factors so as to lump them into the price term of the contract.

(3) Columbia Gas Transmission Corp., Docket Nos. TA81-1-21 and TA81-2-21, Initial Decision issued December 30, 1982 [21 FERC ¶ 63,100].

The holding of the presiding judge in the above proceeding on the Title I issue was contrary to that in the Declaratory Order. The determination of the presiding administrative law judge is not precedential with respect to our Declaratory Order, and will be addressed along with other issues in that proceeding when the proceeding is addressed by the Commission.

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49. *See Tennessee Gas Pipeline Company,* 21 FERC ¶ 61,004 at p. 61,011 (1982): ". . . whether the contracts . . . used in . . . *comparison* contain market out clauses, whether the purchases used in the *comparison* are in fact *comparable,* or whether the contracts under which Tennessee purchases from its affiliates contain more favorable non-price provisions than the contracts underlying the non-affiliated transactions . . . are appropriate subjects for consideration in the hearing . . . on whether Tennessee's purchases from its affiliates satisfy the affiliated entities test . . ." (Emphasis added.)

(4) Notice of Proposed Rulemaking on "Advance Payments."[50]

Similarly, notices of proposed rulemaking are not precedential. Moreover, this notice of proposed rulemaking was issued in 1980, long before we had the thorough analysis of the Title I issue that we have now, and the issue involved has been addressed in the Declaratory Order.[51]

J. Miscellaneous Arguments

(1) Pipeline "Squeeze"

A number of petitioners[52] argue that because of the Commission's holding, pipelines would have no statutory basis for the recovery of certain of their removed substances transportation costs which results in a "squeeze"[53] on the pipelines.

The cases cited by the petitioners are not on point.[54] If there is any squeeze on a pipeline, it results from the

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50. Docket No. RM80-52, issued April 23, 1980. [Proposed Regulations 1977-1981] *FERC Statutes and Regulations* ¶ 32,063, (1980), 45 *Fed. Reg.* 28345 (April 28, 1980); 45 *Fed. Reg.* 35348 (May 27, 1980).

51. As we stated in the Declaratory Order: .

> [T]he "advance payments" program . . . proposed a carrying charge credit for interest received on advances. The notice, however, concerned the proper treatment of monetary advances to producers, and the interest thereon, (or more precisely, the time value of the monies advanced) and was not essentially different from a payment in dollars.

22 FERC ¶ 61,013 at p. 61,022 (1983).

52. INGAA Request at 5-6; Transco Request at 8, n.5; Michigan Wisconsin Request at 2.

53. Citing *Consumer Federation of America, et al. v. F.P.C.*, 515 F.2d 347 (D.C. Cir. 1975), and *Texaco Inc. v. F.P.C.*, 412 F.2d 740 (3rd Cir. 1969).

54. In *Texaco* and *Consumer Federation*, the courts were concerned with the "squeeze" on the pipelines which stemmed from

pipeline's own contracting practices and not on any action of the Commission as was the case in the cases cited. The Declaratory Order does not effect any squeeze. If there is any squeeze at all it simply flows from the statutory enactment and the parties' own contracting practices thereunder. Pipelines have made or can make the appropriate contractual protections part of their gas purchase contracts.

(2) Retroactivity

Some petitioners, even assuming, *arguendo*, that the Commission's Declaratory Order is correct, insist that it cannot be applied retroactively.[55] The Declaratory Order is not legislative in nature, but interpretive in nature. Therefore, there is no legal bar to its retroactive application.[56] Those who filed for a declaratory order were asking this Commission what the statute meant. The Declara-

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making payments that would potentially be both disallowed and non-refundable, and made it clear that any such new "program" would require guidelines for those that might be affected. The Declaratory Order, however, did not set up any "program" of the Commission, but rather it *interpreted* the statutory framework established by Congress in the NGPA. Any impact on the pipelines is a result of the statutory enactment, the pipelines' own contracting practices and the relative bargaining strengths of the parties. For the same reason, petitioners' arguments relating to unlawful confiscation under the United States Constitution are also flawed. (*See, e.g.* Tetco Request at 24-25.)

55. Tennessee Request at 14-15; *see also* INGAA Request at 6, n.2 and 10, n.6; Tetco Request at 23-24.

56. *See e.g., Petrolite Corporation, Bareco Division v. F.E.R.C.*, 667 F.2d 664, 668 (8th Cir. 1981). "[When an order is legislative, then it is proper for it to be prospective], whereas if the order is interpretive, then it should be given retroactive effect. The rationale for this distinction is that a commission or agency creates new law when it issues legislative rules, while it merely applies existing law when it issues interpretive rules." Citing 1 K. Davis, Administrative Law Treatise § 5.09 (1958).

tory Order gave the interpretation requested. Never having given a different interpretation, the Commission has given an interpretation that is effective as of the date of enactment of the NGPA.

(3) Unlawful Discrimination

One petitioner (Tetco) argues that the Declaratory Order causes unlawful discrimination in that it purportedly affects only interstate rather than intrastate pipelines' resale rates.[57]

It is not discriminatory, however, to hold a pipeline to its bargain until it renegotiates that bargain. Nothing suggests that the Declaratory Order does not apply equally to intrastate as well as interstate pipelines' contractual arrangements or that intrastate pipelines will be given any advantage by the respective state regulatory agencies. Moreover, if everything the Commission did in regulating interstate pipelines had to match exactly the treatment of intrastate pipelines by the respective state agencies, the Commission probably could never act.[58]

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57. Tetco Request at 22-23.

58. Cases cited by Tetco are not on point. In *American Public Gas Association, et al. v. F.P.C.*, 546 F.2d 983 (D.C. Cir. 1976), for example, there was an appeal of an FPC order raising from seven percent to nine percent the rate of interest to be paid on refunds. The order limited the nine percent rate to cases where the company's rate filing took place on or after October 10, 1974. The petitioners asserted that it was discriminatory not to make the nine percent rate effective for all refunds ordered by the Commission after October 10, 1974. The court agreed but clearly there was no interstate vs. intrastate discrimination at issue in that case that relates to Texas Eastern's argument; *City of Chicago, Illinois, et al. v. F.P.C.*, 458 F.2d 731 (D.C. Cir. 1971), *cert. denied*, 405 U.S. 1074 (1972), the other case cited, involved an appeal of the Federal Power Commission's decision to allow pipeline producers the same rate of return on new production from leases acquired after October 7, 1969 as it allowed independent producers, and again is not on point with regard to the intrastate/interstate discrimination argument made by Tetco.

III. Order

In light of the foregoing discussion, the Requests for Rehearing filed in Docket No. GP82-50-001, *et al.*, are hereby denied.

APPENDIX D

NATURAL GAS POLICY

§ 3301. Definitions

For purposes of this chapter—

* * *

(20) *Sale.*—The term "sale" means any sale, exchange, or other transfer for value.

§ 3311. Inflation adjustment; other general price ceiling rules

* * *

(b) Rules of general application.—

* * *

(9) Effect on contract price.—In the case of—

(A) any price which is established under any contract for the first sale of natural gas and which does not exceed the applicable maximum lawful price under this subchapter, or

(B) any price which is established under any contract for the first sale of natural gas which is exempted under part B of this subchapter from the application of a maximum lawful price under this subchapter,

such maximum lawful price, or such exemption from such a maximum lawful price, shall not supersede or nullify the effectiveness of the price established under such contract.

§ 3320. Treatment of State severance taxes and certain production-related costs

(a) Allowance for State severance taxes and certain production-related costs.—Except as provided in subsection (b) of this section, a price for the first sale of natural gas shall not be considered to exceed the maximum lawful price applicable to the first sale of such natural gas under this part if such first sale price exceeds the maximum lawful price to the extent necessary to recover.—

(1) State severance taxes attributable to the production of such natural gas and borne by the seller, but only to the extent the amount of such taxes does not exceed the limitation of subsection (b) of this section; and

(2) any costs of compressing, gathering, processing, treating, liquefying, or transporting such natural gas, or other similar costs, borne by the seller and allowed for, by rule or order, by the Commission.

(b) Limitation on State severance taxes.—The State severance tax allowable under subsection (a)(1) of this section with respect to the production of any natural gas may not include any amount of State severance taxes borne by the seller which results from a provision of State law enacted on or after December 1, 1977, unless such provision of law is equally applicable to natural gas produced in such State and delivered in interstate commerce and to natural gas produced in such State and not so delivered.

(c) Definition of State severance tax.—For purposes of this section, the term "State severance tax" means any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas—

(1) by any State or Indian tribe (as defined in section 3316(b)(2)(B)(ii) of this title); and

(2) by any political subdivision of a State if the authority to impose such tax, fee, or other levy is granted to such political subdivision under State law.

§ 3414. Enforcement

(a) General rule.—It shall be unlawful for any person—

(1) to sell natural gas at a first sale price in excess of any applicable maximum lawful price under this chapter; or

(2) to otherwise violate any provision of this chapter or any rule or order under this chapter.

SUBCHAPTER VI—COORDINATION WITH NATURAL GAS ACT; MISCELLANEOUS PROVISIONS

§ 3431. *Coordination with Natural Gas Act*

* * *

(b) Charges deemed just and reasonable.—

(1) Sales.—

(A) First sales.—Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if—

(i) such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter; or

(ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to part B of subchapter I of this chapter.

(B) Emergency sales.—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any sale authorized under section 3362(a) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established under such section and applicable to such sale.

(C) Sales by intrastate pipelines.—For purposes of sections 4 and 5 of the Natural Gas

Act, any amount paid in any sale authorized by the Commission under section 3371(b) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established by the Commission and applicable to such sale.

(D) Assignments.—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid pursuant to the terms of any contract with respect to that portion of which the Commission has authorized an assignment authorized under section 3372(a) of this title shall be deemed to be just and reasonable if such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter.

(E) Affiliated entities limitation.—For purposes of paragraph (1), in the case of any first sale between any interstate pipeline and any affiliate of such pipeline, any amount paid in any first sale shall be deemed to be just and reasonable if, in addition to satisfying the requirements of such paragraph, such amount does not exceed the amount paid in comparable first sales between persons not affiliated with such interstate pipeline.

(2) Other charges.—

(A) Allocation.—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for transportation, storage, delivery or other services provided pursuant to any order under section 3363(b), (c), or (d) of this title shall be deemed to be just

and reasonable if such amount is prescribed by the President under Section 3363(h)(1) of this title.

(B) Transportation.—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for any transportation authorized by the Commission under section 3371(a) of this title shall be deemed to be just and reasonable if such amount does not exceed that approved by the Commission under such section.

(c) Guaranteed passthrough.—

(1) Certificate may not be denied based upon price.—The Commission may not deny, or condition the grant of, any certificate under section 7 of the Natural Gas Act based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable under subsection (b) of this section.

(2) Recovery of just and reasonable prices paid.—For purposes of sections 4 and 5 of the Natural Gas Act, the Commission may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if—

(A) under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act, and

(B) such recovery is not inconsistent with any requirement of any rule under section 3341 of this title (including any amendment under section 3342 of this title),

except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.